PROCEEDINGS

OF THE

ACADEMY OF POLITICAL SCIENCE

Volume XVII] JANUARY 1938 **[No. 4**

EXPENDITURES OF THE FEDERAL GOVERNMENT

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE ANNUAL MEETING OF THE ACADEMY OF POLITICAL SCIENCE
NOVEMBER 10, 1937

EDITED BY

JOHN A. KROUT

THE ACADEMY OF POLITICAL SCIENCE
COLUMBIA UNIVERSITY
1938

PREFACE

AT a time when business recession is so much in men's minds, and when taxation is so obviously a primary concern of the Congress, it is reasonable to expect that this volume on "Expenditures of the Federal Government" will arouse more than academic interest. Governmental policy is apparently in process of revision. The remarks of the Secretary of the Treasury, recorded in these pages, may foreshadow a significant change in the administration's use of public funds. During the coming months the relation of relief and public works expenditures to the general program of recovery and reform will be subjected to critical examination. No present calculation can determine the result. Nevertheless, we publish this issue of the PROCEEDINGS in the hope that frank discussion may help to clarify some phases of the complicated budgetary problem.

These papers, representative of the views of men whose opinions command attention in financial, governmental and academic circles, were presented at the Fifty-seventh Annual Meeting of the Academy of Political Science, held at the Hotel Astor in New York City, on November 10, 1937. It is appropriate for the Academy to express its appreciation of the notable public service rendered by the speakers who participated in either the formal program or the informal discussions. To the Committee on Program and Arrangements credit is due for the success of the meeting. Its members included: Wesley C. Mitchell (Chairman), Miss Ethel Warner (Director), Earle Bailie, W. Randolph Burgess, Nicholas Murray Butler, Lewis W. Douglas, Frederic W. Ecker, Leon Fraser, S. Parker Gilbert, Luther Gulick, George L. Harrison, Thomas W. Lamont, Ogden L. Mills, Shepard Morgan, Thomas I. Parkinson, William L. Ransom, Gordon S. Rentschler, George Roberts, David Sarnoff, Carl S. Shoup, Thomas J. Watson, John H. Williams and Owen D. Young.

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THE NATIONAL BUDGETS OF GREAT BRITAIN, FRANCE AND THE UNITED STATES, 1928-1937

INTRODUCTION *

DR. W. RANDOLPH BURGESS, *Presiding*
Deputy Governor, Federal Reserve Bank of New York
Trustee of the Academy of Political Science

THIS is the Annual Meeting of the Academy of Political Science in its fifty-seventh year. Let we remind you that over this period of years, the Academy has held available a forum for the impartial, non-political discussion of public questions.

The subject for our meeting this year is " Expenditures of the Federal Government ", and the session this morning has as its subject, " The National Budgets of Great Britain, France and the United States, 1928-1937 ". The subject implicitly recognizes that these three great countries have a certain kinship in their budgetary problems.

We have come through the inflationary period of the War together, through a deflation, through the great expansion of the nineteen-twenties and through a great depression.

These great economic causes have brought us problems of the budget which are related, and our subject today will give us, in a sense, a comparative conspectus of budgetary problems from which we may learn something for this country.

Let me remind you that at the close of the set program there will be discussion, first, by speakers whose names appear on the program; then the discussion will be open to the house. That has always been a feature of Academy meetings.

* Opening of the First Session of the Fifty-seventh Annual Meeting.

For our three major papers, we have three distinguished economists from three great universities; men who have had considerable practical as well as university experience. They served with tax commissions in the various states of this Union and in foreign countries. They have been advisers to governments, both here and abroad. Their writings are known to all who are familiar with the field of taxation and the budget.

The first speaker will be Professor Harley L. Lutz, Professor of Public Finance, International Finance Section, Department of Economics and Social Institutions, Princeton University, who will speak on the problems of Great Britain with its national budget.

I have great pleasure in introducing Professor Lutz!

ENGLISH FINANCIAL POLICY AND EXPERIENCE, 1928—1937

HARLEY L. LUTZ
Professor of Public Finance, Princeton University

THIS paper deals with some of the more obvious aspects of the English financial record and experience since 1928. In order that the general facts of this record may be more easily visualized, certain statistical tables have been prepared.

The fiscal results of the years 1928 to 1937 inclusive may be expressed compactly as follows:

1. On the face of the record, there was a surplus of receipts over expenditures in the ordinary accounts in six of these years and an excess of expenditures in four years. The surpluses aggregated £64,949,000 and the deficits totaled £75,696,000. The net excess of expenditures over current receipts for the ten years was therefore £10,727,000.

This is not a wholly accurate picture, for some extra-budgetary transactions have modified the apparent results in the direction of a larger total deficit for the period. Such transactions have not been of a magnitude, however, that would completely invalidate the impression of prudence in financial management which is conveyed by the ordinary accounts.

2. The maximum increase in the total deadweight debt was £415,500,000. This occurred between 1930 and 1934. The changes in the composition of the debt have been somewhat complicated, but the total increase does not indicate extra-budgetary expenditures to the full amount thereof. A moderate increase of the nominal debt capital occurred in connection with the conversion of 1932-33 and a substantial amount was borrowed in these years to establish the exchange equalization fund.

On the other hand, there were heavy deficits for certain years in the unemployment insurance fund, and loans were made to provide these payments. Such loans are not counted in the deadweight debt, but in the other capital liabilities of the state.

Presumably it is expected that, over a sufficiently long period, the receipts of this fund may suffice to liquidate the special loans, which would justify treating these obligations as being in the class with those incurred to provide capital funds for other self-supporting enterprises. From time to time substantial payments against the unemployment deficit have been made.

I. *Some Generalizations Regarding the English Finances*

It is worth while to attempt certain broad generalizations regarding English financial policy and experience during the past decade, after which attention will be directed to some more specific aspects of the revenues, the expenditures and the debts, respectively.

First, the traditional regard for a balanced budget continued to exert strong influence upon fiscal policy. From the cessation of the War, the party in opposition, whatever its label, has found the government's expenditure and taxation proposals an inviting point of attack. The criticism has been, at times, captious rather than constructive, but it has always been active.[1] Although vigorous, the post-war budgetary criticism lacked the insight necessary to suggest, and the force required to compel, the adoption of financial and economic policies appropriate to the conditions that had been created by the return to the gold standard in 1925.

The English budgeting process during these years may be likened to a series of moderate oscillations around the norm of perfect balance. Like his fellows elsewhere, the British politician is inclined to temporize, to accept makeshifts, and to rely unduly on the efficacy of expedients. Moreover, he is no better at reading the future than any one else. Mr. Churchill's remarks in closing the budget speech of 1929 strongly resemble some things that were frequently heard here. He said:

> I feel that the corner in our economic fortunes may well now have been turned. There are no causes, apart from fresh causes of our own making, which should prevent the next four or five years being easier and more fruitful than those through which we have made our way.[2]

[1] *Cf.* Mallet and George, *British Budgets, Third Series, 1921-1933, passim.*

[2] Quoted by Mallet and George, *op. cit.*, p. 263.

No one realized then, of course, that difficulties were impending which would make the trying days of the coal strike seem, by comparison, like a fairly prosperous period. While these difficulties disorganized the finances and increased the temptation to rely on expediency, they did not wholly demoralize the fiscal processes nor loosen altogether the British grasp of fundamentals. It is true that the original budget for the fiscal year of 1932 was a " makeshift " affair, the enactment of which constituted a temporary triumph of political expediency which seemed at the moment to brighten the prospects of the Labor Government. As the prospective deficit under it increased, the government continued unwilling to make adjustments along the lines recommended by the May Committee on national expenditure,[3] and in August 1931, a cabinet crisis was precipitated by the split over unemployment policy, itself a fruit of the earlier optimism regarding the future outlook for industry.

In presenting the supplementary budget, Mr. Snowden, who, as chancellor, had been responsible for the earlier makeshift proposals, announced that the revised program contained " drastic and disagreeable " proposals. The significant thing about this crisis and the way in which it was met is that while the British may muddle and temporize and err, they do not altogether lose sight of the chalk line of budgetary balance. The promptness with which drastic and disagreeable action was taken in 1931 reveals the apprehension which any threat to budgetary stability will develop in England.

A second general feature of the English fiscal situation over the past decade has been the comparative steadiness of both the revenues and the expenditures. This is to be expected under a " pay-as-you-go " philosophy. The receipts naturally performed better than the expenditures, for they were under somewhat better control. That is, a government which, at the critical junctures, can muster the political courage to use the taxing power as a means of preserving budgetary equilibrium can take steps, however drastic and disagreeable they may be, to increase its receipts, or to control them in this sense. It has no such control over the effects of a world-wide

[3] *Report of the Committee on National Expenditure*, 1931 (Cmd. 3920), House of Commons Sessional Papers, 1930-31, vol. 16.

depression on the domestic economy and on the volume of the expenditure obligations that may be created by the impact of outside forces.

A third characteristic of the English record is the material reduction of the annual debt service charge. Many nations have taken advantage of the abnormal conditions of the depression capital market to convert or refund high rate war securities into new paper bearing much lower rates. The success of the English conversion of 1932-33 was a factor of the greatest importance in the budgetary improvement from 1934 to 1936. The reduction of more than £100,000,000 in the annual interest cost of the debt provided a shock absorber against the increased expenditures for public relief and in aid of local governments.

A fourth element in the general situation has been the enormous debt total which the English people have been carrying since the War. This has had a tremendously sobering effect on their fiscal policy. From 1919 to the present the deadweight debt has stood above the absolute level to which wild schemes and lavish expenditures have now raised our own national debt. Under these circumstances there has been strong discouragement to any program of liberal spending to be supported by further borrowing.

There must have been some temptation and some pressure to abandon the traditional standards in 1931, despite the debt burden, for at the time that the original budget for 1932 collapsed, there was a prospective deficit of £74,679,000 for 1932 and of £170,000,000 for 1933. The choice of a way out is described by Mallet and George as follows:

> Two paths had stretched before Mr. Snowden—the obvious one of increased taxation and drastic economies, and the other, enthusiastically advocated by certain economists and politicians, the less dismal-looking but unknown and dangerous path of further borrowing, leading to inflation and all it entailed, economically, financially and politically. This path was one which Mr. Snowden, with his orthodox principles of budgetary balancing, would probably neither care nor dare to look at twice, even if an overwhelming majority of his new colleagues and the full force of the City, fearful at the possible loss of the gold standard, had not irresistibly forced him toward the other path, of crushing taxation and rigorous retrenchment—the path of safety and of sacrifice.[4]

[4] *Op. cit.*, p. 392.

The policy of crushing taxation and rigorous retrenchment did not save the gold standard, for suspension occurred within a fortnight after the introduction of the supplementary budget. More than governmental retrenchment was required, and the other, deeper adjustments of the domestic economy were so severe and so extensive as to have been, in all probability, impossible.[5] Nor can we be wholly certain that if England's debt burden had been much less, the path of safety and of sacrifice would have been chosen. The section of the other path that one sees from the entrance to it is lined with some particularly choice and attractive political and economic primroses. The briars and the greasy skids are all farther along the way.

II. *Some Aspects of the English Revenues*

From this brief survey of the situation as a whole we pass to a consideration of the exchequer receipts.

The taxation revenues are obviously of paramount importance. The national government has done little to develop those functions which may be summed up in the phrase, " The State as landlord and capitalist ". Even its limited rôle here has not escaped all criticism, for the " Sundry " and " Miscellaneous " classes of receipts have included such things as repayments of loans and advances, transfers of capital reserves to current account, and liquidation of property assets, especially war materials.[6] The treatment of all such proceeds as current receipts has produced a critical reaction similar to that which has been directed against our own policy of dumping R. F. C. and other agency collections into the hopper of current expenses.

The importance of the income tax in the British fiscal scheme is clearly shown in Table I, and the figures reveal, further, that the strength of this tax is in the standard, or as we would say, the normal tax.[7] Since 1928 the proportions of total in-

[5] *Cf.* Frederic Benham, *British Monetary Policy,* especially ch. iii.

[6] In 1932 the miscellaneous revenues included £8,075,000 of capital repayments from the exchange account.

[7] Originally, the additional tax was called the "super tax". The name was officially changed in the Finance Act of 1927, in connection with a scheme of simplifying administration for both the government and the taxpayer.

TABLE I

SUMMARY OF EXCHEQUER RECEIPTS FOR CERTAIN FISCAL YEARS

(Millions of Pounds)

	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938 (Estimated)
Customs	111.6	118.9	119.9	121.4	136.2	167.2	179.2	185.1	196.6	211.3	219.9
Excise	139.2	134.0	127.5	124.0	119.9	120.9	107.0	104.6	106.7	109.5	113.2
Motor Vehicle Duties	24.5	25.4	26.8	27.8	27.5	27.9	30.7	31.5	30.8	32.7	34.0
Estate, *etc.*, Duties	77.3	80.6	79.8	82.6	65.0	77.1	85.3	81.4	87.9	88.0	89.0
Stamps	27.0	30.1	25.7	20.7	17.1	19.2	22.7	24.1	25.8	29.2	29.0
Land Tax, House Duty, Mineral Rights	.8	.8	.9	.8	.9	.8	.8	.8	.8	.7	(d)
Income Tax	250.6	237.6	237.4	256.0	287.4	251.5	228.9	228.9	238.1	257.2	288.1
Surtax (or Super tax)	60.6	56.2	56.4	67.8	76.7	60.7	52.6	51.2	51.0	53.5	58.0
Excess Profits & Corpn. Tax	1.8	1.7	2.3	3.0	2.5	2.2	1.8	2.3	1.3	1.0	1.5
Sub-total, Tax Revenues	693.4	685.3	676.7	704.1	733.2	727.5	709.0	709.9	739.0	783.1	832.7
Post Office (net)	6.2	8.1	9.2	10.1	11.5	10.9	13.1	12.2	11.7	10.9	11.8
Crown Lands (net)	1.1	1.2	1.3	1.3	1.3	1.2	1.2	1.3	1.4	1.4	1.3
Sundry Loans & Investments	24.0	28.1	32.6	32.9	13.8	5.1	4.7	4.4	4.9	4.6	4.3
Miscellaneous	61.4	56.5	36.4	34.3	29.9	22.9	22.1	15.1	21.7	24.6	11.0
TOTAL RECEIPTS	786.1	779.2	756.2	798.7 (a)	793.5 (b)	767.7	750.1	742.9	778.7	824.6 (c)	863.1 (e)

Sources: For 1938, Financial Statement of April 20, 1937. For all other years, the respective Finance Accounts.

Notes: (a) Total includes £16,000,000 from rating relief suspense account. (b) Total includes £3,990,000 from rating relief suspense account. (c) Total includes £100,000 from post office fund. (d) Included with excess profits and corporation tax. (e) Total includes £2,000,000 from National Defense Contribution.

come tax yield have been quite steady at 80 and 20 per cent, for the standard and the surtax, respectively. This is in striking contrast with the results of personal income taxation under the federal law, where the surtax rates regularly produce much more than the low normal tax. The disposition to rely heavily on severe rates, that under the most favorable circumstances can be levied against only a small proportion of the total number of taxable incomes, intensifies the fluctuations of federal income tax yield. The maximum product of the British tax during this period was £364,607,000 in 1932, one of the worst depression years, and the minimum was £280,042,000, in 1935. The maximum was 1.3 times the minimum. In the United States the peak yield of the income tax between 1928 and 1935 was $2,348,500,000 on the returns of the year 1928, and the lowest yield was $615,500,000, on the returns for 1932. In our experience the maximum was 3.8 times the minimum. The English know how to use the income tax to get revenue, and they do not complicate or distort its operation as a fiscal instrument by undertaking to make it serve various non-fiscal purposes at the same time.

While England depends on the income tax in far greater degree than is the case in this country, she does not rely exclusively on it, by any means. It is the largest single source of revenue, and even after taking account of the local rates, it provides a handsome proportion of all national and local tax receipts. But this proportion is well below one half of all national tax receipts, while it is at times more, and again somewhat less, than a third of all national and local tax receipts. Indirect taxes, viz., customs, excises and stamp taxes, have achieved together a degree of importance in the English fiscal scheme that may surprise some who have assumed that the better-publicized income tax is not only the foundation, but also a large part of the superstructure of British finance. In fact, the customs receipts have been the only branch of the revenue that has shown an uninterrupted increase year by year over the past decade. Various factors in the economic situation of Great Britain have contributed to this result, and the about-face toward a nationalist tariff policy has apparently not been accompanied, as yet, by rate increases so severe as to interfere seriously with the revenue possibilities of the tariff.

At the beginning of the period under consideration, the Colwyn Committee was submitting its elaborate report on National Debt and Taxation.[8] This report is of interest in the present connection because of the emphasis given to continued debt reduction and the divergence of views within the committee over the proper kind of tax policy. The majority conceded the theoretical superiority of direct taxation but took a realistic view of the need and advantage of a broader tax base than is possible under this method of taxation alone. It also rejected the capital levy. The minority vigorously criticized the indirect taxes, stoutly upheld the idea of still heavier taxes on incomes and estates, and defended the capital levy in the form advocated by the Trades Union Congress.

Nevertheless, when we include with the income tax the estate duties and that part of the motor vehicle licenses paid on vehicles used for personal rather than for business purposes, it is still possible to regard England as the great exponent of direct taxation. Together, over the past decade, these forms of direct taxation have accounted for more than one half of the national revenues.

This high proportion has been achieved, however, only through the levy of severe rates. In 1928 the standard rate of income tax was 4 shillings in the pound, or 20 per cent. By 1932 it had been advanced to 5s., or 25 per cent, and after a slight reduction in 1935 and 1936, this rate is now again 5s. The personal exemptions have varied inversely with the standard rate and the minimum exemptions have been as low as £125 of earned income or £100 of investment income for an unmarried person. Additional allowances for dependents and for various other claims establish somewhat higher minima for the average British taxpayer, and the present tendency is to lessen the tax on small incomes. Thus, in 1937, a married man with two children could earn £375 before becoming liable to tax. But the tax begins to bite, and bite hard, at a much lower income level than we are accustomed to reach. The surtax begins at £2,000 and finishes its progression at £50,000. The maximum rate on income above this figure has been as high as 8s.-3d., or 41¼ per cent.

[8] *Report of the Committee on National Debt and Taxation*, 1927, (Cmd. 2800).

There are two major forms of death duty. The more important of these is the estate duty, levied on the net value of the estate at rates ranging from 1 per cent when the value is between £100 and £500, to 50 per cent when the value is £2,000,000 or more. The rate appropriate to each bracket applies to the entire estate and not simply to that portion within the bracket limits, as is the case with our own use of tax rate progressions.

The second major form of death duty is a tax on the share received by the beneficiary. It is called legacy duty when the property transferred is personalty, and succession duty in so far as this property consists of real estate. The rates are graduated from 1 to 10 per cent according to the degree of kinship between the heir and the testator and the size of the bequest. The relative importance of the estate and inheritance taxes is shown by the following statement of net receipts for the year 1935.[9]

Estate duty	£71,591,000
Legacy duty	8,632,000
Succession duty	1,106,000

Only the most cursory reference can be made to the remaining forms of taxation. The bulk of the customs revenue is derived from the imports of alcoholic beverages, tea, sugar, tobacco, oil, and the groups of goods covered by the Ottawa duties and the Act of 1932. In 1935 the oil duty produced £47,800,000. The rates have been deliberately adjusted to provide from this source at least enough to cover the grants to local governments. The most productive excise duties are those laid on liquors, sugar, entertainments, matches, artificial silks, and various dealer licenses.

The chief bone of contention in these taxes has long been the taxation or exemption of the English breakfast table. In the years following the War the motion to repeal the tea duty became as fixed a part of the budget consideration as the address from the throne. Each year the chancellor would express his sympathy with the purpose and his deep regret that the state of the finances did not permit granting the request. In 1928,

[9] From the *Seventy-eighth Report of the Inland Revenue Commissioners*, 1934-35, p. 10. An additional succession duty raises the maximum to £11-10s. per cent, and there are other minor death duties which raise the total of such levies to seven.

variety was added by a medical member who opposed the exemption on the ground that tea is not a food and that the drinking of stewed tea three or four times a day was producing a race of nervous dyspeptics. Hence a reduction of the price would be contrary to public policy.

Nevertheless, the tea duty was repealed the next year and the fact that a general election was at hand led to violent attack on the motive. The financial pressure compelled restoration of the duty in 1931 and it has since been good for some six to seven million pounds of revenue yearly.

The motor vehicle licenses are also severe, by our standards. The rate for ordinary vehicles is now 15s. per horse power or fraction thereof, which helps to explain why the English refer to the Ford V-8 as a " big car ".

The diversion of part of the motor vehicle revenues from the road fund has been a source of sharp debate for years. A similar controversy has emerged in more than one of the states. There, as here, the motor car owners, the good roads organizations, and their several allies, have demanded full and complete dedication of this tax to the highways, while the harassed budget officers have been unable to resist the temptation to divert part of this ready cash to other purposes. The situation is aggravated in England by the complete diversion of the oil import duty, which naturally includes the gasoline tax, to other purposes. But neither in England nor the United States can the issue of a dedicated road fund be settled dogmatically. Everywhere vast sums will be required to correct the mistakes of earlier hasty road building, in the interest of greater traffic convenience and safety.[10] On the other hand, some matters may be more urgent than the gains to be made in the highway program through the use of the diverted part of the funds.

The latest tax proposal, offered in connection with the budget for 1938, was a graduated tax on recovery profits, to be known as the National Defense Contribution.[11] This plan aroused a

[10] In *The Economist* of August 21, 1937 (vol. 128, p. 371), the estimate is given that £800,000,000, would be required for the completion of an adequate program of road construction and improvement.

[11] The text of the proposal may be found in the *Statement of Revenue and Expenditure*, April 10, 1937. *Cf.* the criticisms of the proposal in volume 127 of *The Economist*, April–July, 1937, *passim*.

TABLE II

SUMMARY OF ENGLISH EXPENDITURES ON THE BASIS OF EXCHEQUER ISSUES FOR CERTAIN YEARS
(Millions of Pounds)

Expenditures	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938 (Estimated)
A. Consolidated Fund Services											
1. National Debt											
a) Interest	312.0	310.1	304.9	291.9	287.6	280.1	215.2	210.6	210.5	209.8	209.8
b) Management	1.8	1.4	2.3	1.3	1.9	2.1	1.1	1.0	1.0	1.1	1.1
c) Sinking Fund	65.0	57.5	47.7	66.8	32.5	26.3	7.7	12.4	12.5	13.1	13.1
Sub-total, Debt	378.8	369.0	354.9	360.0	322.0	308.5	224.0	224.0	224.0	224.0	224.0
2. Road Fund	19.7	21.1	21.9	22.9	22.5	22.9	25.5	26.4	25.8	27.4	(a)
3. Local Taxation Accts.	15.4	15.2	13.3	.3	(b)	(b)	(b)	—	—	—	—
4. North Ireland Exchequer	5.3	5.1	5.5	6.4	6.3	6.9	6.6	6.8	7.2	8.0	8.0
5. Other Consol. Fund Serv.	3.7	2.8	3.3	2.6	3.0	3.2	4.1	3.6	5.6	3.2	3.2
Sub-total, Consol. Fund Serv.	422.8	413.2	399.0	392.2	353.9	341.7	260.2	263.2 (c)	263.7 (c)	263.1 (c)	235.5 (c)
B. Supply Services											
1. Army (incl. ordnance)	44.2	40.5	40.5	40.2	38.5	35.9	37.6	39.7	44.6	54.8	63.7
2. Navy	58.1	56.9	55.8	52.6	51.1	50.0	53.5	56.6	64.8	81.1	78.1
3. Air	15.2	16.1	16.8	17.8	17.7	17.1	16.8	17.6	27.5	50.1	56.5
4. Miscellaneous Civil	229.8	222.5	246.5	307.4	320.1	342.9	338.7	345.6	361.9	367.7	405.2
5. Revenue Admin.	11.7	11.6	12.0	11.9	11.8	12.4	12.1	12.6	13.1	13.4	13.9
Sub-total, Supply Services	359.0	347.6	371.6	429.9	439.2	458.3	458.7	472.1	511.9	567.1	627.4 (d)
GRAND TOTAL, Expenditures	718.0	760.8	770.6	822.1	793.1	800.0	718.9	735.3	775.8	830.2	862.9 (e)
Surplus +, or deficit —	+4.3	+18.4	—14.5	—23.4	+ .4	—32.3	+31.2	+7.6	+2.9	—5.6	+ .2

Sources: See Table I.

Notes: (a) Road Fund abolished. Appropriations included with Civil Votes. (b) Less than £100,000. (c) To Post Office Fund: 1936, £1,127,000; 1937, £421,000; 1938, £300,000. Included in totals. (d) Total includes £10,000,000 for supplementary estimates. (e) Exclusive of £89,000,000 to be raised under National Defense Act of 1937.

fierce storm of protest and criticism. It was finally withdrawn, to be replaced later in the session by a revised version which omitted some of the most objectionable features of the first draft, but which was, none the less, a steeply graduated tax on British profits.

III. *Some Aspects of English Expenditures, 1928-1937*

The summary facts of the English expenditure record are given in Table II. They are arranged under two major headings, the Consolidated Fund Services and the Supply Services. The former are provided under permanent appropriation acts and the latter are voted annually.

The changing relative importance of the two groups is striking. The Consolidated Fund Services have declined, absolutely and relatively, owing to the saving through debt conversion, the reduction of sinking fund payments under the stress of the depression, and the substitution of the block grants for the payments to local taxation accounts. The appropriation to the North Ireland Exchequer represents the residue of taxes collected there after deducting certain administration expenses and a contribution from that area to the general imperial government.

The defense expenditures must be passed over without comment, since we cannot, at this distance, form a sound judgment either as to their necessity or as to their adequacy to assure the ultimate objective of all such expenditure. The marked overall increase in this group for 1937 and 1938 takes no account of the special defense expenditures to be financed by loans.

The item, "Miscellaneous Civil Votes", includes the cost of the general civil functions. Further details for this group are given in Table III, under a combined departmental-functional classification that was introduced in 1928.

An examination of Table III reveals three matters of importance. These are: first, the growth of the contributions to local revenues since 1930; second, the rising importance of the social services; and third, the absence of padding in the strictly overhead services.

Grants to local revenues. Extensive changes in the grant-in-aid policy were made in 1929, accompanied by equally extensive changes in local government and taxation. Since Miss

TABLE III

CLASSIFICATION OF PURPOSES UNDER MISCELLANEOUS CIVIL VOTES
(Thousands of Pounds)

Class	1927/28	1928/29	1929/30	1930/31	1931/32	1932/33	1933/34	1934/35	1935/36	1936/37	1937/38
I. Central Gov't. and Finance ..	1,993	2,038	2,096	2,042	1,812	1,791	1,905	1,922	1,987	2,290	2,549
II. Imperial and Foreign	7,681	5,580	5,471	6,032	5,581	7,904	8,432	8,044	8,573	9,236	8,989
III. Home Dept., Law and Justice	12,625	12,123	12,358	15,770	16,028	15,333	15,742	16,234	17,239	18,738	23,940
IV. Education	53,258	49,456	50,070	55,116	55,436	51,589	51,062	52,840	55,875	58,502	59,931
V. Health, Labor and Insurance .	72,867	75,905	85,763	107,660	121,273	151,662	150,727	150,819	161,861	161,481	170,167
VI. Trade and Industry	9,948	9,145	10,416	12,612	14,077	9,196	9,289	15,504	16,937	17,816	31,383(a)
VII. Common Services (Works, Stationery, etc.)	8,488	8,230	7,973	8,732	8,911	8,066	7,628	8,090	8,226	9,445	9,899
VIII. Non-effective (Pensions)	58,661	56,184	56,184	54,644	52,122	49,496	49,160	46,787	45,917	45,011	43,934
IX. Miscellaneous (Expiring Services)	665	1,353	909	351	46	—	—	—	—	—	—
X. Exchequer Contributions to Local Revenues	—	—	15,294	44,487	44,819	44,882	45,284	45,400	45,278	45,192	54,392
TOTAL CIVIL VOTES	229,815	222,493	246,535	307,445	320,105	342,920	338,683	345,640	361,923	367,711	405,184

Sources: See Table I.
Notes: (a) Road Fund abolished. Road appropriations to be included in Group VI.

Newcomer has so recently described the new system and its effects, this subject must be passed over with a reference to her work.[12] The one observation that may be added here is based on the course of the local rates. In 1929 the amount collected by all local authorities totalled £188,389,000. After the derating of agricultural and other property, this total fell to £163,678,000 in 1933. Then it began to rise and the estimated total of the rates for 1937 was £191,812,000.[13] In other words, the gain from tax exemption through derating and increased grants has already been swallowed up by the increased taxes on other classes of taxpayers. It is a made-to-order illustration for a taxpayers' association in its campaign against taxation without economy.

The social services. The second significant thing revealed by Table III is the great relative importance of the social services. The further details of England's payments for such purposes are given in Table IV.

This table, which is in three sections, embraces more than the national budget. It assembles the expenditures by all public authorities, central and local, under various welfare acts. One section is historical, the others are analytical.

Historically viewed, education and poor relief were the primary social services in 1900. The principal addition by 1910 was the old-age pension. Another decade brings unemployment insurance, war pensions, and definite activity in housing, hospitalization, mental treatment, maternity and child welfare. The one further addition by 1930 is the transitional benefit, which is paid to those who have used up their unemployment insurance benefit but are not yet on a payroll.

The unemployment benefits from 1930 to 1935 throw interesting light on the cabinet crisis of 1931. The Labor Government fell because the party refused to support a cut in the

[12] Mabel Newcomer, *Central and Local Finance in Germany and England* (1937), pp. 161 *et seq.*

[13] *Cf. Financial Statement,* 1937-38, p. 10. Land and buildings used in agriculture were completely exempted from local rates. Property used in mining, manufacturing and transportation was to be rated at 25 per cent of annual value. Railroads had already had a reduction of annual value to 25 per cent for the levy of certain rates, hence the new arrangement meant an assessment basis of one sixteenth of annual value for these rates. *Cf.* Newcomer, *op. cit.*, p. 184 and note.

TABLE IV

TOTAL NATIONAL AND LOCAL EXPENDITURES ON SOCIAL SERVICES IN CERTAIN YEARS
(Millions of Pounds)

Operating Expenditures on Social Services, England, Wales, Scotland						Sources of Receipts, 1935				Character of Expenditure, 1935			
Purpose	Fiscal Years					Specific contributions, fees, rents, interest	Parliamentary votes	Local rates and block grants	Total receipts	Debt service	Administration	Benefits, etc.	Total
	1900	1910	1920	1930	1935								
Unemployment Insurance													
1) Insurance Benefits	—	—	10.8	81.3	52.9	42.1	21.0	—	63.1	4.9	4.1	43.9	52.9
2) Transitional Payments	—	—	—	20.3	46.2	—	46.2	—	46.2	—	4.0	42.2	46.2
National Health Insurance	—	—	29.8	38.6	36.7	33.8	6.7	—	40.5	—	5.6	31.1	36.7
Widows', Orphans', Old Age Contributory Pensions	—	—	—	34.6	43.2	23.6	(b)	—	23.6(b)	—	1.3	41.9	43.2
Old Age Pensions	—	7.4	20.8	37.5	42.4	—	42.4	—	42.4	—	.7	41.7	42.4
War Pensions	—	—	100.9	49.2	41.2	—	41.2	—	41.2	—	1.0	40.2	41.2
Education	20.1	34.2	90.3	104.9	106.3	8.7	49.1	48.5	106.3	6.7	4.7	94.9	106.3
Housing	.5	.9	4.7	40.0	46.1	27.5	15.7	2.9	46.1	32.9	.3	12.9	46.1
Poor Relief	12.4	16.2	34.3	38.5	49.2	3.4	.4	45.4	49.2	.7	2.6	45.9	49.2
Public Health Acts, relating to													
1) Hospitals and Treatment of Disease	1.6	2.2	8.6	10.5	13.8	(			)	1.3	(a)	12.4	13.8
2) Maternity and Child Welfare	—	(a)	2.1	3.2	3.4	(2.8	.4	20.8	23.8)	.1	(a)	3.3	3.4
Lunacy and Mental Treatment .	1.1	2.2	4.4	5.8	6.6	(			)	1.0	.1	5.5	6.6
TOTAL	36.0	62.9	306.6	468.3	488.0	141.9	223.0	117.5	482.5	47.6	24.4	415.9	487.9

Source: *Public Social Services* (Total Expenditure under certain Acts of Parliament) November, 1936. (Cmd. 5310.)

Notes: (a) Less than £100,000. (b) There was an Exchequer contribution of £13,000,000 to the Treasury Pensions Account.

insurance benefits. These were cut later by the National Government and in 1935 nearly £30,000,000 less was paid under this head. But the transitional benefits, paid to substantially the same group of recipients, had increased in the same time by more than £25,000,000.

No comment is needed on the record of the war pensions except to say that a reduction of this relative magnitude is the reasonable and logical trend for the expenditure on such a service, as the war period recedes in time. In 1936 we were still paying some pensions on account of the War of 1812, and we may be profoundly thankful, therefore, that no American troops were used in the Battle of Waterloo.

Poor relief expenditure increased steadily to 1935, notwithstanding the large sums that were being spent under all of the other welfare categories. The explanation probably is that the various types of insurance benefit payments represent the central government's struggle to aid those who are normally gainfully employed, while poor relief represents the activity of the local units in caring for the unemployables, the young, and various other groups of dependents outside the national program.

The preëminence of education among the social services conforms to our own experience. Housing has forged rapidly to the front and it is likely to be an outstanding activity for some time. The foreign observer is in no position to judge the quality of the social results obtained through either of these services, but some hearsay evidence indicates that the standards of new housing construction are none too high. In housing as in highways, the immediate urgency of the problem may encourage jerry-building, which gets the quickest results although it costs more eventually when the earlier mistakes must be corrected. Apparently England has not had to endure, however, the gratuitous extravagance of a Resettlement Administration.

The English reports tabulate the numbers of persons benefiting directly from the several services. Naturally there is much duplication since the same individual may be receiving benefits under several acts at the same time. The most comprehensive feature of the whole program, from the standpoint of the number affected, is national health insurance. This applies to virtually the whole wage-earning community be-

tween the ages of 16 and 65. In 1935 the total number of enrollees was 18,481,000. In this year the number receiving unemployment or transitional benefits was 12,540,000. This figure does not imply an unemployment problem of such magnitude, but it does indicate the very large proportion of wage-earners who are affected in some degree by the fluctuations within their respective occupations. The difference between a benefit system which acts simply as a cushion against the irregularities of employment, and a relief system which must carry a certain group more or less permanently, is shown in the fact that only 1,886,493 persons were supported in 1935 under the poor relief acts, but the cost of their support in this year was third largest among the whole list of the social services.

The second section of Table IV indicates the sources of the funds spent in 1935. The principal point of interest here is the distribution of the burden of each service among individuals, the exchequer, and the local governments. To some extent the local share is borne by the exchequer through the block grants, but no segregation can be made between the local funds derived from this source and those obtained from local rates. In the aggregate, about 70 per cent of the whole cost for 1935 fell on government, that is, on taxpayers. An interesting line of speculation, which can only be suggested here, is an examination of the practical and theoretical relationships that should prevail between the character of the expenditure and the character of the tax system. One group demands heavier direct taxes to support larger welfare expenditures, while another group finds, in the purpose of modern government as revealed by its expenditures for different services, a good case for substantial indirect taxes. A third angle of the problem would be the proper relative proportion to be provided by contributions from beneficiaries rather than by taxation of any sort. This is a very old problem, but it is a perennially new one as the pattern of governmental activities changes.

The third section of Table IV analyzes the expenditures for 1935 according to character. The value of this exhibit is in disclosing the distribution of the relative costs of providing the various benefits, especially for debt service and administration. The heavy debt charge for housing means mortgage interest

and amortization, and not a public debt charge. The small administrative expense for housing suggests the extent to which construction and operation must have been relegated to private hands, backed by public grants and guarantees.

The only other debt item in the list that calls for explanation is under the unemployment fund. The burden on this fund during the twenties had swamped it and the excess of payments over fund receipts was borrowed. The readjustment of benefit payments inaugurated in 1931 did have the merit of putting this feature of the welfare system on a more nearly sound fiscal and actuarial basis, even if it did not greatly reduce the over-all cost of unemployment relief.

The general administrative costs. Reverting again to Table III, it is worth while pointing out that such expansion of governmental functions and costs as has occurred in England over the past decade has not occasioned any material increase in the cost of the general governmental framework. There has been no great army of clerks and other employees added to the public payroll in order to perform this work. It cannot be said that political patronage is nonexistent in England, but it is kept within close bounds. There is no conscienceless raiding of the taxpayer by the spoilsman.

IV. *The English Debt Situation*

The essential facts in the English debt situation over the past decade are summarized in Table V. In the main, this table tells its own story, with the aid of the explanatory notes. A few loose ends should be gathered up, however, to clarify certain transactions having a bearing on the actual budgetary results.

The occasional use, for current purposes, of capital funds which had been obtained through loans, and the necessity of borrowing, until 1932, to meet the full obligations of the unemployment insurance fund, have been mentioned. A matter that is rather obscure is the treatment of the accrued interest on National Savings Certificates. Like our own Treasury Savings Bonds, the interest on these certificates is accrued and paid at maturity, unless they are presented earlier for cash. In practice, the treasury uses the money realized from the sale of new certificates to redeem those presented for redemption. Occasionally, the interest on redeemed certificates has

TABLE V

THE ENGLISH NATIONAL DEBT FOR CERTAIN YEARS

Year	Internal Debt					External	Gross total dead-weight debt	Other capital liabilities	Aggregate capital liabilities
	Funded debt	Terminable annuities	Unfunded Debt						
			Floating	Other	Total unfunded				
1914	586.7	29.6	13.0	20.5	33.5	——	649.8	56.4	706.2
1920	315.0	19.3	1,312.2	5,006.5	6,318.7	1,178.7	7,831.7	46.9	7,878.6
1928	1,350.0	12.6	688.8	4,464.4	5,153.2	1,095.2	7,610.9	103.2	7,714.1
1929	1,478.3	12.5	737.3	4,272.7	5,010.0	1,084.7	7,595.5	120.5	7,716.4
1930	1,456.0	12.2	637.4	4,393.7	5,031.1	1.074.2	7,573.4	127.2	7,700.6
1931	1,425.0	12.0	594.3	4,431.7	5,026.0	1,066.7	7,529.7	169.6	7,699.3
1932	1,467.1	11.7	612.0	4,375.9	4,987.9	1,090.8	7,557.4	214.0	7,771.5
1933	3,376.3	11.9	810.5	2,508.7	3,319.3	1,060.4	7,767.8	215.9	7,983.7
1934	3,374.3	12.1	844.7	2,677.5	3,522.2	1,036.5	7,945.2	208.1	8,153.3
1935	3,368.1	12.1	833.4	2,672.0	3,505.4	1,036.5	7,922.1	102.0	8,023.1
1936	3,366.5	12.1	782.2	2,839.7	3,621.9	1,036.5	7,916.5	105.8	8,022.2
1937	3,364.9	12.1	698.1	2,808.8	3,506.9	1,032.6	7,916.5	112.6	8,029.2

Source: *The Finance Account* of the respective years.

Notes: The *funded debt* is that which has no definite maturity date; the *unfunded debt* is that which matures at a definite future time. The *floating debt* is the total of Treasury bills and Ways and Means Advances. The other unfunded debt includes various bond and note issues.

The finance account deducts from the deadweight debt the bonds and notes tendered in payment of estate and other taxes. Such paper is held by the National Debt Commissioners until it is drawn or paid off otherwise. Inasmuch as there is no immediate cancellation of obligations tendered in payment of taxes, it must be regarded as part of the nation's debt burden. The above table does not take account of such deductions from the debt total.

Other capital liabilities includes loans for capital equipment under various acts particularly for the extension of postal, telephone and telegraph systems. Through 1934 it also includes the accumulated borrowings for the unemployment fund. The drop of the total in 1935 resulted from a separate funding of these loans as an obligation of the Unemployment Fund. The Exchequer stands as ultimate or contingent guarantor.

exceeded the appropriation for this purpose from the Consolidated Fund, and the difference has been borrowed. Such loans were made in 1930, 1932 and 1933, to an aggregate of £15,906,000.

The government's liability on outstanding certificates is not clearly stated, in that it is uncertain whether the certificate capital liability which is included in the unfunded debt takes account of accrued interest or not. A footnote is always appended giving the amount of this accrual, and as of March 31, 1937, this was approximately £124,000,000. *The Economist's* discussion of the debt position as of March 31, 1936, indicates that the accrued interest is not included, for the final tabulation of the debt load includes the accrued certificate interest as an additional item.[14]

V. *Conclusion*

In conclusion, three points that are suggested by the foregoing discussion will be mentioned, although there will be no opportunity for elaborating upon them.

The first is the question of the wisdom of the choice made in 1931, when England deliberately turned away from the allurements of borrowing and inflation as the way to meet the depression obligations. Devaluation, which was in no sense a result of deliberate choice in 1931, had particularly significant effects since it was not quickly followed by a corresponding readjustment of the internal price level.[15]

As we look back now over the record, it is difficult to question the wisdom of the English policy. The special obligations of the depression were met, not on the scale that some would have preferred, perhaps, but on a standard of minimum adequacy. The great argument for our own extravagance was that no American family should be allowed to starve. The English death rate from starvation since 1930 has been no higher than ours.

The English and the American ways of handling a great economic depression are in striking contrast. It is too soon

[14] *Cf. The Economist*, vol. 127, p. 8 of Budget Supplement to issue of April 10, 1937.

[15] *Cf.* M. Fourre-Cormeray, *L'Equilibre Budgetaire en Grande Bretagne*, 1930-1936. The author stresses the transformation in England's position which resulted from the depreciated currency, the adoption of protectionism, and the control of national industry in the interest of greater social security.

to measure finally the relative merits of the two plans, but it is not too soon to express unstinted admiration for a fiscal policy which avoided so many of the foolish, expensive and dangerous errors that have been evident in our own policy.

The second question is the ability of England to carry her load, a load which is primarily the result of the War, but with heavy additions imposed by post-war developments, both external and internal. Statistics of the so-called national income are somewhat suspect, but no better basis of measurement exists. In 1929, total expenditures equaled 17.6 per cent of estimated national income. The combination of declining income and rising expenditures raised this ratio to 20.8 per cent in 1932, but it had dropped to 17.1 per cent in 1936. The estimate for 1937 is 18.1 per cent.[16]

The long-run effects of the present fiscal load upon the national productivity should be, and probably are, a matter of concern to informed Englishmen. The present severe rates of income and estate taxation are certain to affect, ultimately, the growth of capital and the volume of the nation's productivity, although these effects may be imperceptible over short periods. England, like the United States, has her advocates of wealth redistribution through increasingly severe taxation. Nowhere does this group recognize the necessity of shortening the financial sails as their goal is achieved, in order to get the budget and the debt whittled down to a scale appropriate to the time when there will be no large estates or large incomes to tax.

Finally, the immediate outlook is darkened by the cost of the rearmament program. A natural question is whether this departure from the traditional standard of the balanced budget is to be permanent or only temporary. In favor of the latter interpretation is the fact that the increased expenditure is based rather on necessity than on a specious rationalization of the great domestic benefits to be realized from a substantial increase of the public debt.

Remarks by the Chairman

Dr. W. Randolph Burgess: Thank you, Professor Lutz.

The next speaker will be Professor Robert Murray Haig, McVickar Professor of Political Economy, Columbia University, who will discuss French budgetary problems.

[16] *Cf. The Economist, loc. cit.*, p. 12.

THE NATIONAL BUDGETS OF FRANCE, 1928-1937

ROBERT MURRAY HAIG

McVickar Professor of Political Economy, Columbia University

IN this rapid review of the budgetary experiences of the three great democratic nations during the depression, we turn from the cheerful and inspiring picture of Great Britain to the tragic and depressing picture of France. For our sketch of the French situation, a background of bold pencil strokes is supplied by this paragraph of a British commentator:

> Judged by British standards, the French financial machine continuously creaks. In some ways too, it has to carry a heavier load. France has had to meet the cost of the last war and the reconstruction of the devastated areas. Today she also has to meet the cost of rearmament and of the new social programme. All this has to be met out of a national income which has been depressed by the war, by the post-war inflation and by the trade collapse and deflation of 1929-36. She has to do all this in an atmosphere of distrust, born of the inflation of the early twenties and the devaluation of 1926-28 and fostered by the financial losses and difficulties of recent years. She has to carry on with a monetary and banking system which makes uneconomical and wasteful use of her gold reserves, with a fiscal system which never succeeded in preventing tax evasion, and with an absence of confidence which is only too ready to translate itself into a flight of capital abroad. Today the country is starved of liquid funds, of working capital, and this is the bane of Government finance and of the general trade and industry.[1]

At the outset of the period under review, there were high hopes that the budgetary picture for the ensuing decade would be a brilliant and attractive one. It was true that France had only recently emerged from the valley of the shadows of bankruptcy; but, in 1926, the country, under the leadership of Poincaré, had at long last abandoned hope that Germany would pay all war and reconstruction costs and had reconciled herself to the necessity for meeting these costs herself, chiefly by sacrificing four fifths of the value of her franc. This plan involved tremendous burdens, especially for the great middle

[1] *The Banker*, London, vol. 43, no. 138 (July 1937), pp. 6-7.

class, but it was carried through with resolution and spirit. By utilizing both retrenchment and tax adjustments, the public fisc was put in order, and in 1926 and 1927, for the first time in a decade and a half, the budget showed a small favorable balance.[2]

[2] Definitive figures of aggregate receipts and expenditures of the ordinary budget for the period 1926-1935, as set forth in the *lois de réglement*, are summarized in the 1937 budget *Projet*, submitted July 24, 1936 (No. 822, ler volume, Chambre des Députés, Seizième Législature, Session Ordinaire de 1936, *Projet de Loi portant fixation du Budget Général de L'Exercice 1937*, Paris, Imprimerie Nationale, 1936, p. xii), as follows:

	Receipts	*Expenditures* (*Figures in millions of francs*)	*Surplus* (+) *Deficit* (—)
1926	43,064	41,976	+ 1,088
1927	46,086	45,361	+ 725
1928	48,177	44,248	+ 3,929
1929 [a]	64,268	58,850	+ 5,419 [c]
1930	50,794	55,712	— 4,918
1931	47,944	53,428	— 5,484
1932 [b]	36,038	40,666	— 4,628 [d]
1933	43,436	54,945	— 11,509
1934	41,070	49,883	— 8,813
1935	39,485	49,868	— 10,383

[a] Fifteen months ended March 31, 1930.

[b] Nine months ended December 31.

[c] An official estimate of the surplus for this year, reduced to a twelve-month basis is 4,335 million francs. *Ibid.*, p. xlvi.

[d] An official estimate of the deficit expanded to a twelve-month basis is 6,171 million francs. *Ibid.*

In connection with the above table the operations of the extra-budgetary Autonomous Amortization Fund should be studied. This fund was established in 1926 to assist with the servicing of the public debt. It was endowed with certain revenues that had formerly alimented the ordinary budget, some of which were now definitely earmarked for amortization. The precise manner in which the items of receipts, expenditures and surplus (in the above table) should be modified, if one desired to consolidate the accounts of the ordinary budget and the accounts of the Autonomous Amortization Fund, is not always clear, the situation being complicated by such considerations as these: the receipt of substantial sums from the budgetary surpluses (1927, fr. 490,000,000; 1928, fr. 1,500,000,000; 1929, fr. 2,000,000,000); and the receipt of proceeds of loans (1932, fr. 1,174,100,000; 1934, fr. 124,200,000). In discussing the surpluses and deficits of France it would certainly appear proper to take into account the net amount of the debt amortized by the Fund. Indeed, writing in 1933, Hugh Dalton (*Unbalanced Budgets*, p. 437, footnote) contends that, taking sinking funds into account, "in the last few years there have been no deficits." In the 1937 *Projet* (p. xlvi, *vide supra*) the following figures are given as the payments made by the Autonomous

In 1928, the first year of our period, the budgetary surplus was increased to very substantial proportions, nearly 4 billion francs in excess of expenditures of approximately 44 billions, and, in the following twelve months, another surplus of a similar magnitude resulted.

However this fourth successive surplus, that of 1929, proved to be the last of the sequence. In 1930 mounting expenditures (not declining revenues) produced a deficit of nearly 5 billions. At this point the revenues began to feel the full effect of the depression and reductions in expenditures could not be made to keep pace with the diminished tax collections. The budgetary deficits for the three years 1930, 1931 and 1932 averaged about 5 billions annually and for the next three years,

Amortization Fund for contractual redemption of the public debt (in millions of francs):

1931	1,094
1932	1,853
1933	1,877
1934	1,981
1935	2,823

Corresponding figures published by the Economic Intelligence Service of the League of Nations (*Public Finance, 1928-1935*, XI, France, p. 15) differ somewhat from those cited above. These are given below together with the figures for "other redemption operations" of the Fund (in millions of francs):

	Contractual redemption	*Other redemption operations*
1928	——	5,783
1929	——	8,992
1930	——	4,898
1931	1,043	6,046
1932	1,784	7,040
1933	1,812	3,063
1934	1,920	953

With the materials at his disposal in this country, the writer has not been able to analyze the operations of the Fund in sufficient detail to enable him to suggest the definite modifications which should be made in the budgetary deficits to take account of the amortization accomplished by the Fund.

The 1937 *Projet* (p. xlvii) also gives the following figures for the military expenditures financed on a special basis by the treasury (in millions of francs):

1931	208
1932 [a]	836
1933	1,134
1934	749
1935	2,118

[a] Nine-month figures adjusted to a twelve-month basis.

1933, 1934 and 1935, they averaged double that figure, or about 10 billion francs annually. The year 1935 is the last for which the accounts have been definitively stated; but it is known that the deficit in the ordinary budget last year (1936) was in excess of 8 billions [3] and that there were additional uncovered expenditures for public works and rearmament of 9.5 billions.[4] When Blum resigned a few months ago the outlook for this current year, 1937, was for another deficit in the ordinary budget of about 8 billions plus an item of more than 22 billions for rearmament, public works, etc., to be financed outside the budget.[5] To what figure Bonnet may succeed in reducing this prospective deficit before the year closes remains to be seen.

At the beginning of this current year, 1937, the aggregate of the seven annual deficits accumulated in the ordinary budgets since 1930, when the present series of deficiencies began, thus amounted to about 54 billion francs. If one tries to refine this figure, by taking extraordinary items into account, he is led to the conclusion that the true aggregate deficiency instead of being 54 billions is probably somewhere in the neighborhood of 70 billion francs, the unfavorable item of extra-budgetary expenditures apparently being substantially in excess of the favorable item of extra-budgetary amortization of debt.[6]

[3] At the time of writing, the latest available reports regarding the ordinary budget give the following figures for 1936 (in millions of francs):

	Receipts	*Expenditures*	*Deficit* (—)
1936	38,446	46,531	—8,085

These figures are published in the *La France Économique en 1936*, p. 89, and are based on data which appeared in *J. off.* du 28 février, 1937 and *J. off.* du 11 juillet, 1937.

[4] *Ibid.*, p. 93.

[5] *Projet*, 1938 Budget, p. xiii. The "credits opened" relating to this class of expenditures for the *exercice* 1937 aggregated nearly 20 billions when the 1938 budget *projet* was submitted. No. 2697, Seizième Législature, Session Ordinaire de 1937, *Projet*, 1938, p. 97.

[6] This estimate is based on these facts. Between March 31, 1930 and December 31, 1935, the total domestic debt rose from 280 billions to 333 billions (see League of Nations, *op. cit.*, p. 18 and 1937 *Projet*, p. 196), an increase of 53 billions during a period when the deficits in the ordinary budget aggregated less than 46 billions. Apparently the figure of 53 billions should be increased by 3.2 billions, representing the permanent advances of the Bank

An aggregate accumulation of deficits amounting to 70 billions of francs will probably not seem particularly disturbing to most Americans, particularly in view of the fact that French budgetary revenues have been averaging about 40 billions annually during the depression. Our aggregate of federal depression deficits is about five times our average budgetary revenues; in France such deficits aggregate less than twice their annual revenues. This suggests that the French situation is more sensitive than our own. Our "road to ruin" is a highway on which we have been able to travel a long distance at high speed without reaching the terminus. France's "road to ruin" is relatively short; she cannot travel far or fast on that road without soon finding herself in the environs of disaster.

Although the economic depression began to make itself felt in France soon after the date of its impact in America, it was less rapid in its development and less severe in some of its effects. For example, the income of the people of France fell 30 per cent in the six years after 1929; in America the figure of "income produced" fell 51 per cent in three years.[7] While the decline in wholesale prices in France was roughly equivalent to the American decline, the American decline

of France, an item included in the 1930 statement but excluded from the 1935 statement. But this increase was probably largely if not completely offset by a reduction in the amount of the foreign commercial debt, which between 1930 and 1932 declined 2.5 billion francs (League of Nations, *loc. cit.*). There should be added to the 1935 figure of 53 billions the 1936 deficit.

[7] The estimates of "Les Revenus Privés" given by L. Dugé de Bernonville (*La France Économique en 1936*, p. 61) and the Department of Commerce estimates of national income produced in the United States (*Survey of Current Business*, June 1937, p. 12) are as follows:

	In billions of francs	*In billions of dollars*
1929	245	81.0
1930	243	68.0
1931	229	53.6
1932	206	39.5
1933	199	41.8
1934	184	49.6
1935	172	55.0
1936	189	63.8

Contrary to what might be inferred from the heading, the French figures do not exclude all governmental figures. For example the pensions covered by the public budgets are included.

reached its low point in 1933, whereas the French price level continued downward until 1935.[8] Moreover in France the unemployment problem did not develop to proportions such as ours; as late as February 1934 only 351,000 persons in France were in receipt of unemployment relief, and at its peak, in February 1935, this figure was less than a half-million.[9]

So gradual was the onslaught of the depression that hopes were seriously entertained in many quarters that France would prove to be insulated against some of its most chilling blasts. However, whatever frail foundations there may have been for such hopes were rudely blasted away by the depreciation of the pound and the dollar which transformed the franc from an overvalued to an undervalued currency. With memories of the inflation of the twenties still fresh among her people, France chose what was probably the only course of action that was politically feasible, namely, one designed to balance the budget and defend the integrity of the Poincaré franc. After four years of struggle, with one government after another trying its hand at the compression of expenditures and the expansion of taxation, while prices melted and the economic mechanism moved at a diminishing pace, only last year it fell to the lot of a radical government, specifically pledged against currency depreciation, to acknowledge the struggle to be hopeless. With two strokes the Poincaré franc was cut in half and now, with general economic conditions less favorable than in almost any other country, France is settling down for another attempt to end her régime of unbalanced budgets.

Let us glance for a moment at the outstanding features of the budgetary problem as France passed through the various phases of the depression. As we have seen, a budget balance was achieved by Poincaré which persisted until 1930. But this balance was established only at the very peak of a curve of prosperity and only at the cost of deferring a major readjustment of governmental salaries, made inevitable by the loss in the purchasing power of the franc. The large budgetary

[8] *La France Économique en 1936*, pp. 16, 36.

[9] Sir Robert Cahill, *Economic Conditions in France* (dated June 1934) No. 581, Department of Overseas Trade (London, H. M. Stationery Office, 1934), p. 635. *Bulletin Economique, Chambre de Commerce de Paris*, May 1937, p. 7.

surpluses of 1928 and 1929 furnished the occasion for the accomplishment of this readjustment and, largely because of increased costs ascribable to this step, the budgetary expenditures rose from 44 billions in 1928 to nearly 56 billions in 1930. Because of the lag in tax collections, 1930 was a banner year for revenues, nearly 51 billions being collected, but the depression was already well under way and the series of unbalanced budgets had begun. Although prices were rapidly falling, the French civil servant was loath to relinquish his hard-won salary adjustment. The whole expenditure schedule was difficult to compress, the large items of debt service and pensions being especially rigid. Thus, as late as 1933, with the national income at 199 as compared with 245 in 1929, and with revenues down to 43.4 billions, the expenditures of the ordinary budget remained practically at the 1930 peak, at 55 billions. Even two years later, in 1935, in spite of the strenuous measures of Doumergue and Laval, which included repeated salary reductions and cuts in pensions and in the interest on government bonds,[10] budgetary expenditure had been reduced only slightly below 50 billions; and by this time the revenues, in spite of all efforts to bolster them, had faded to 39.5 billions, a sum too small to have balanced even the Draconian budget of 1926. Direct taxes, which produced 10.2 billions in 1929, yielded only 5.5 billions in 1935 and even the revenues from indirect taxes and monopolies dropped nearly one-third in the same period.

In the meantime the accumulation of budgetary deficits and extra-budgetary expenditures had begun to make serious trouble for the treasury. Signs of an exhaustion of borrowing power began to appear in 1934. In connection with the Poincaré stabilization, careful safeguards had been thrown about the Bank of France and these began to make difficulties in connection with the absorption of the treasury paper.[11] The great commercial banks showed a reluctance to increase their holdings of treasury bills when they could not be rediscounted at the Bank of France. The government then brought pressure

[10] Pensions and debt service alone account for approximately one-half the expenditures in the budgets of recent years.

[11] For a good account of these difficulties, see William H. Wynne, "The French Franc, June, 1928–February, 1937", *The Journal of Political Economy*, August 1937, pp. 501 *et seq.*

on the bank to consent to a relaxation of standards and safeguards. In the ensuing struggle the bank lost first its governor, then its safeguards and, ultimately, its character.

By June 1936, it had become fairly evident that the continuance of efforts to pare expenditures and to plug up holes in the tax system would not suffice to achieve budgetary equilibrium and France was ready for some new line. Casting her eye across the waves she saw in these United States not, forsooth, a balanced budget, but at least a high rate of business activity and a rising national income. Moreover she saw that, even in a depression, steps toward a more abundant life for the masses were being taken. She was impressed and, through a union of the parties of the Left, she put Léon Blum into power. Blum's attitude toward the policy which had previously been followed in France is made clear in the following sentences taken from the budget *Projet* submitted in June 1936:

> To the extent that it has succeeded in achieving its objectives, the policy of deflation, by reducing purchasing power, has impaired the chances of recovery.
>
> To each new burden, to each new retrenchment, to each new swoon of our national economy, the response has been new fiscal deficits. The economic deficit has aggravated the fiscal deficit. The fiscal deficit has dried up the sources of loans while multiplying the needs for loans. And the repeated resort to credit has burdened the money market, has increased the interest rate and has crushed simultaneously the budget and the economic life of the country.[12]

Blum determined to attempt to break this vicious circle, so familiar to all depression budgeteers, but he had other worthy aims as well. In his own words, recently uttered:

> The Government's primary need was naturally to bring to an end the state of crisis with which it was faced. This implied the revival of the French economic system which had been weakened by five years of depression.... The Government, however, did not intend to rest content with the mere rescue of the country from the depths of the depression and the restoration of the years of relative prosperity experienced after the War. It desired the restoration of prosperity, it is true, but it also wished to combine prosperity with justice. This meant the elimination, as far as possible, of all the inequities of the present economic régime, leaving only the utmost possible measure of justice and well being.[13]

[12] No. 822, Chambre des Députés, Seizième Législature, Session Extraordinaire de 1926, p. xiv.

[13] *The Banker*, July 1937, pp. 9, 10.

In addition, the threatening foreign situation made it necessary simultaneously "to provide the means needed to protect France's frontiers and to enable France to fulfil her international engagements", in other words, to finance an extensive rearmament.

The practical program evolved to achieve this objective may be fairly accurately described as a faint carbon copy of the New Deal. Its history is well summarized in an epitaph from the pen of the Paris correspondent of the London *Times:*

> Where the Government erred was in pursuing a financial policy whose aim was reflation, that is to say, the increase of purchasing power, while at the same time introducing social reforms whose effect was to retard output and reduce the supply of commodities available to buyers whose incomes had been increased. . . . Equally disastrous was M. Vincent Auriol's truculent attitude towards employers and capitalists; he does not seem to have realized that within the framework of the capitalist system social reform can be paid for only out of the profits of industry and that if the entrepreneur is frightened out of his wits profits disappear and with them the basis itself for eleemosynary legislation.[14]

No comment is offered other than to point out that, under French conditions, which are more sensitive and restricted than our own, our prescription did not bring the results hoped for.[15] Last June Blum resigned and Ambassador Bonnet was called from Washington to assume command in the red-plush chambers of the Louvre and to deal with a situation in some respects more desperate than that faced by Poincaré in 1926. A few weeks after his arrival Bonnet confided to the voters in his home town of Perigneux that his policy and program also found its inspiration in the land across the waves. He said that his last interview in Washington was with Mr. Roosevelt and that the last words said to him by Mr. Roosevelt were, "Whatever else you do, balance the budget!"[16] There is no record of Blum's reaction to this address. Perhaps he comforted himself with Bernard Shaw's obviously unjust aphorism,

[14] Issue of August 23, 1937.

[15] Another factor of probable significance for the Blum experiment is the degree of the dependence of the economy upon foreign trade, which is greater in France than in the United States. See speech of Léon Blum, *Le Populaire*, September 20, 1937.

[16] *New York Times*, August 23, 1937.

that "those who can, do; those who cannot, teach." In any case we can comfort ourselves with the thought that in the hour of France's extremity we were able to offer her assistance both by our precept and by our example and that, finding them in direct conflict, she has listened to our advice and has followed our precedent.

Bonnet has been granted wide powers. He thinks he has succeeded in balancing the ordinary budget. He has relieved the stress on the treasury and has arranged an enormous credit at the Bank of France. He has secured from Ministerial Council a declaration that is currently interpreted as an abandonment of efforts to secure social reform at this juncture and has appealed to the country to save its currency "by a great national effort of industry, of discipline and of unity." [17]

The picture we have sketched is not a cheerful one. It has been justly charged that the financial policy of France during the last depression has been vacillating and hesitant; but it must also be conceded that the task faced by the finance ministers of the last decade has been appallingly difficult. Certainly the depression, with its series of seven consecutive budgetary deficits, has taken a heavy toll. There has been a serious deterioration in the strength and stability of her financial structure. The Poincaré franc, which was considered impregnable in 1928, and which was tenaciously defended until 1936, has lost half its value in a little more than a year. Recently prices have rocketed upward, the general index of wholesale prices, which stood at 400 on September 10, 1936, being reported at 611 on October 30, 1937.[18] The price rise carries with it the seeds of another salary adjustment for the civil service. The depression persists. The outlook is not reassuring. Nevertheless let us hope that the efforts of Bonnet to prevent a further impairment of the French national economy will be crowned with success, and that our great sister republic will soon achieve that measure of tranquillity which is essential for full economic and financial recovery.

[17] *Le Temps*, October 3, 1937.

[18] *New York Times*, November 8, 1937.

REMARKS BY THE CHAIRMAN

DR. W. RANDOLPH BURGESS: Thank you, Professor Haig.

Against this backdrop, beautifully painted, we can now bring on the stage the subject of our particular interest, the budgetary problems of the United States.

It gives me great pleasure to introduce Professor Fred R. Fairchild, Professor of Political Economy, Yale University.

THE UNITED STATES BUDGET IN THE PAST DECADE

FRED ROGERS FAIRCHILD
Knox Professor of Political Economy, Yale University

IN this paper I make no attempt to delve into the intricacies of technical budget making. My task is rather to explore the recent financial experience of the United States government for the sake of the broad picture of national finance and the significant conclusions that may be drawn therefrom.

There is however one technical matter which may not be disregarded and which I wish to dispose of once for all at the start. In dealing with government financial operations it is essential always to distinguish those receipts which represent real revenue from other receipts, and similarly distinguish between the true costs of government and other payments. Adherence to this rule compels departure from the official figures at one point. The Victory Liberty Loan Act of 1919 set up machinery for retiring the World War debt by requiring certain annual appropriations to the sinking fund, beginning July 1, 1920, to be expended for debt retirement. Since this is a definite obligation imposed by Congress, the treasury treats these retirements of debt like cost payments, classifying them under "expenditures chargeable against ordinary receipts". These are obviously not cost payments, since they result in equal reductions of the national debt. In order to show the true picture of governmental costs, I shall exclude these statutory debt payments from my figures of costs.[1] Their inclusion in the official reports makes the governmental costs and the annual deficits appear greater and the surpluses smaller than they really are. So much for technicalities.

I shall confine my inquiry chiefly to the finances of the United States government during the decade just past, although

[1] *Cf.* F. R. Fairchild, "The Government's Financial Reports", *American Economic Review,* March 1935, pp. 31-43.

to get a good running start I may have to take my first position a bit earlier.

Every war occasions extraordinary expenditures during the period of actual conflict and generally for a year or two thereafter. The United States may fairly be said to have reached a stage of financial equilibrium after the World War with the fiscal year 1922. Whereas the total expenditures of the national government (excluding debt retirement) were eighteen and a half billion dollars in 1919, six and a half billions in 1920, and five billions in 1921, they dropped down to $3,373,000,000 in 1922 and continued between three billions and three and a half billions through the following nine years.

During this period the national finances were in flourishing shape. What with the rising tide of business activity and economic prosperity, official inclination toward economy, and conservative budgeting, each year generally turned out better than previously estimated, and the generous budget provisions for debt reduction were thus substantially exceeded. In the eleven year period from 1919 to 1930 the national debt was reduced by the extraordinary sum of ten and a half billion dollars.

This happy chapter was interrupted by the panic of 1929. However, since the income taxes and certain other revenues rest chiefly on bases in the previous year, the decline in business and in personal incomes did not affect the public revenue materially until the fiscal year 1931. In that year the total revenue receipts dropped to $3,190,000,000, being almost a billion dollars ($988,000,000) less than the previous year. Expenditures had been gradually increasing since 1926, and attempts to combat depression by government financial action appeared in 1931, causing further expenditure. But it was chiefly the drastic shrinkage of revenue which was responsible for the year's closing with a deficit of 462 million dollars.

The succeeding record of deficits and mounting public debt, uninterrupted from 1931 to the present time, is in its broad lines familiar to us all. The national revenues continued to shrink, finding their low level in the two fiscal years 1932 and 1933. In each of these years the revenues—barely over two billion dollars—were just about half of the annual revenues of the eight year period from 1923 to 1930.

In the meantime expenditures began a more rapid upswing, jumping over a billion dollars in 1932, to four and three-quarters billions, and reaching a maximum of eight and a half billions in 1936. They were just over eight billions in 1937 and are officially estimated at seven and a third billions for the current fiscal year, 1938.

In 1932 an important revenue act was passed, and other tax measures followed, notably the Revenue Acts of 1935 and 1936. But it is noteworthy that these tax measures generally had regulatory and administrative objectives quite as much in view as the desire for enlarged revenue, and there has not been during this period any vigorous attempt to secure an increase in taxation proportional to the rise in governmental costs. However, thanks to the turn of the economic tide plus the moderate revenue results of tax legislation, the public revenues increased by about a billion dollars in 1934 and continued their rise till in 1936 they were back to the pre-depression level of about four billions. In 1937 the revenues were five and a quarter billions, and the President has predicted six and two-thirds billions for 1938.

Budget making in the decade just passed has labored under extraordinary difficulties. Discrepancies between the presidential budget estimates and the actual results of each year's finance have generally been large and sometimes on their face grotesque. For example, the actual revenues of 1932 were barely half the predicted sum. In 1936, revenues actually exceeded slightly the budget estimate. Expenditures have consistently run far beyond the estimates—by nearly two billion dollars in 1937, for example. The budget of 1932 predicted a surplus of $440,000,000, and the year finally closed with a deficit of $2,750,000,000. Deficits have generally been far greater than predicted.

I have sought thus to pass in review—all too hastily, I realize —the pageant of national finance during a period of extraordinary disturbance in general economic and political conditions. Of the many significant features that stand out in this review I propose to select two or three for special comment.

Most obvious of all is the rather frequent inability of our budget marksmen—not, shall we say, to hit the bull's eye—but to come anywhere near the target. From 1923 to 1930

we find revenues invariably underestimated, at times by discrepancies ranging from a quarter to a half billion dollars, representing errors of nearly 10 per cent in some years and 20 per cent in one year. During this period the predictions of expenditures were closer, though tending generally to be too low.

After 1930, the estimates become more erratic. Revenues are generally, though not always, overestimated—in 1931 by over a billion dollars (25 per cent) and in 1932 by nearly two billions (nearly 50 per cent). Expenditures are consistently underestimated—in each of four years by more than a billion dollars, in 1934 by three and a half billions. These represent errors of 30 per cent in some cases and over 100 per cent in 1934. The deficits have been correspondingly underestimated. The budget predicted a surplus of $440,000,000 for 1932; the year closed with a deficit of $2,735,000,000. For 1933, the budget deficit was 923 millions, the actual deficit over two and a half billions. The budget prediction of a 494 million dollar deficit for 1934 materialized as an actual deficit of more than three and a half billions. Mr. Roosevelt's first budget predicted a deficit of just over three billions. The deficit in 1937 was more than five times the amount predicted in the budget.

Of course every student of public finance realizes that no administration in this country can be expected to reach anything approaching an exact prediction of revenues and expenditures, or even any such precision as is obtained, for example, in Great Britain. In the first place we do not have that unity between the executive and the legislature which, as in Great Britain, permits executive enforcement and control of the budget. In America the President makes the budget estimates, but the Congress has the final say as to revenues and expenditures, and it may take action upsetting the fiscal plan of the executive. Thus Congress added an item of $1,673,000,000 to the expenditures of 1936, contrary to President Roosevelt's plan and over his veto. In this connection it is worthy of note that for more than three years we have not had a full-fledged director of the budget; a part-time acting director has been in charge.

Decisions of the Supreme Court may throw out a revenue measure upon which the President counted, as in the case of

the processing taxes in 1936, although here it would seem that the administration must bear some responsibility at least for not having made a better guess at the constitutionality of its fiscal proposals. Again, the President can hardly be held accountable for failure of his budget estimates when control passes to another president and a Congress of different political complexion. Mr. Hoover obviously had no control over the finances of the fiscal year 1934, for which he made prediction in December 1932.

It is also to be remembered that the period I have chosen for study was a troublous one, and we must recognize that predicting revenues and expenditures, for a period ending eighteen months in the future, has been no easy task these past seven or eight years. He would be a captious critic who would condemn the administration for not always forseeing accurately the course of the depression that started in 1929. Mr. Hoover can hardly be blamed for failure to know, in December 1929, that the general business situation would knock a billion dollars off the national revenues in the year ending on June 30, 1931. On the other hand, it is difficult to be quite so charitable in connection with his missing the 1932 revenues a year later by nearly 100 per cent, though even here there were extenuating circumstances. Mr. Roosevelt has done rather better in predicting revenues, but the depression had already passed its low mark when he took charge. And his forecasts of expenditures and deficits have been generally very wide of the mark.

After all is said, I think we might fairly have asked a somewhat better showing. A good deal of our budget workmanship, especially in recent years, has a distinctly amateurish flavor. It is not easy to avoid a suspicion of bias when we find predictions erring so consistently on one side. The Republican administrations before the panic laid themselves open to the charge of underestimating revenues in order to accomplish conservative financing and rapid reduction of debt, and there is reason to think that Mr. Roosevelt may have been willing, by overestimating revenues and underestimating expenditures, to put as good a face as possible on the finances of his "New Deal". The American people are, I believe, justified in demanding from those intrusted with the conduct

of their national finances a higher standard of budget making and a more scrupulous regard for sincerity in financial statements than has recently been shown.

Beginning with the first budget of the Roosevelt administration, that of 1935, the annual budget estimates of expenditures have been divided into two parts, known respectively as the "General Expenditures" and "Emergency" or (as in the later budgets) "Recovery and Relief Expenditures", and the Treasury Department follows the same division in its reports. Into the "emergency" budget were put, for example, the expenditures of the Reconstruction Finance Corporation, the various emergency public works administrations, the Agricultural Adjustment Administration, Emergency Conservation Work, Farm Credit Administration, Federal Land Banks, and some dozen other agencies whose names have in these last years become more or less household words.

This division is intended to mean, by implication if not by official declaration, that the "emergency—recovery and relief—expenditures" are such as have been necessitated by a state of emergency and that the general budget shows what the cost of government would be were no such emergency present. On this assumption the annual deficit assumes a different face. President Roosevelt has frequently called attention to the fact that the receipts are equal to or in excess of the "general" budget. The "general" budget is in balance, and the year's deficit is relegated to the "recovery and relief" budget. Thus in his estimates for the then current year 1934, the President pointed out a surplus in the general budget of $214,000,000. At the same time the anticipated expenditures for "recovery and relief" were such as to indicate a deficit for the whole budget of $7,309,000,000. The actual figures of revenue and expenditure for the years 1934-1937 and the budget figures for 1938 show revenues in excess of the "general" expenditures in every year but one (1936).

Without charging any intent to deceive, it can readily be shown that the use of the double budget has tended to obscure the true picture of the national finances. It has been a natural inference that the enormous deficits of recent years have been wholly the result of emergency expenditures and that when, at some future date, the "emergency" is over, the total of

ordinary expenditures will drop to a level indicated by the "general" budget—easily covered by existing revenue sources.

Any such inference is quite erroneous. After every period of extraordinarily increased expenditure, the United States has found its federal government on a new level of permanent costs far above that which existed before. Up to the time of the Civil War the annual per capita cost of the national government was never much more than two dollars; after the Civil War it never fell below four dollars. In 1916 the total ordinary expenditures of the United States government were $742,000,000. Since the World War they have never been below three billions except in one year (1925, when the amount was $2,931,000,000). No one with any knowledge of fiscal history should have been so naïve as to suppose, in 1934 or 1935, that at the close of the existing "emergency" the cost of the national government was destined to drop back to the level of three billion dollars, more or less, at which it had stood for the decade ending in 1931 and which was still the amount of the "general" budget.

By now the facts are gradually becoming clear. The peak of expenditure for "recovery and relief" ("emergency") was in 1934, when the amount was four billion dollars in a total expenditure of six and three-quarters billions. Since then the so-called "recovery and relief expenditures" have been steadily declining, till in the budget prediction for 1938, as revised to October 18, 1937, they stand at $2,016,000,000, barely over half the figure of four years ago. Does this perchance indicate that, as the emergency is passing, we are getting back to the pre-depression level of expenditures? Let us see.

A considerable part of the decrease in the "recovery and relief" costs is due to transfer of certain expenditures from "recovery and relief" to the "general" budget. The Tennessee Valley Authority's expenditures were transferred about half to "general" costs in 1936 and are entirely there in 1937 and 1938. The Emergency Conservation Work was transferred entirely, under the title Civilians' Conservation Corps, to the "general" budget in 1936 (though the Treasury Department still reported it under recovery and relief), and it has since remained in the "general" budget. Such transfers

obviously reduce the total expenditures reported in the "recovery and relief" budget, but they do not bring any reduction in the cost of these projects. For the sake of a true picture of the trend, these items should be added to the "recovery and relief" costs as officially reported in each year since the transfers were made.

A further distortion of the reported cost of "recovery and relief" comes from certain practices in official accounting. Several of the special "recovery and relief" agencies, engaged primarily in making loans, are now showing net income over and above their expenditures. The official reports enter only the net receipts for such agencies and combine them with the net expenditures of the other agencies in the total cost of "recovery and relief". This means that in the total figure, not only is no account taken of the sums actually expended by these particular agencies, but their net receipts are allowed to reduce by so much the net expenditures of other agencies. There may be some question whether the actual expenditures of these agencies should not be included and their total receipts elsewhere recorded; but there is, I think, no question that the net expenditures of all agencies should be included regardless of the net receipts of others. This correction may be made by adding to the official reports of "recovery and relief" costs the sum of the credits that entered into the reported totals.

If we make these corrections for net credits and important items transferred in later years to the "general" budget, we find the following record of expenditures for recovery and relief:

Year	*As reported*	*Adjusted*
1934	$4,002 mil.	$4,002 mil. (no adjustment)
1935	3,657 "	3,855 "
1936	3,291 " [2]	3,702 "
1937	2,846 "	3,827 "
1938 (estimate)	2,016 "	2,527 "

[2] C.C.C. expenditures were already included, in accordance with Treasury Department reports.

Here we have a very different picture. The real costs of "recovery and relief" have diminished only slightly from their peak in 1934 to the last completed year, 1937—a decline of only $175,000,000 dollars, or less than four and a half per

cent. The 1937 cost was actually greater by $125,000,000 than the cost in 1936. The year 1938, it is true, shows still an impressive reduction; and it is only reasonable to anticipate in this current year a considerable real decline in the cost of unemployment relief. But we must remember that the figures for 1938 are only the budget estimates and that this year has still seven and a half months to run. Already the official estimate (combining "recovery and relief" and revolving funds) has been raised by $200,000,000, and past experience should warn us to look for further substantial increases before the year's books are closed.

If it is an error to take the apparent decline of "recovery and relief" expenditures as proof of any substantial reduction of the "emergency" costs, it is equally erroneous to regard the figures as indicating a return to the pre-depression cost of government, or indeed any substantial reduction at all. Reductions in the so-called "recovery and relief" costs have been offset by increases in the "general" budget, partly on account of the transfers to which I have referred, partly by actual increases. For example, the "general" expenditures of 1936 increased over 1935 by more than two billion dollars, or nearly 65 per cent. The budget estimate of "general" expenditures for 1938, $5,330,000,000, is greater by about two billion dollars than the total cost of the national government in any year from 1922 to 1930. There is no longer the slightest ground for pretending that the present heavy cost of government is due alone to the demands of emergency. In the 1938 estimate, almost half of the increase that has come since 1930 is in the "general" budget, as officially reported.

The total cost of the national government in 1936 was eight and a half billions, exceeding the previous year by one and a half billions. For 1937 the total cost is still over eight billions. The present budget estimate for 1938 is seven and a third billions, and we may confidently anticipate substantial increases before the year is over. I claim no clairvoyant powers and wish to make no prophecies. But the record of the past decade and the lessons of previous fiscal experience would indicate that, so long as present policies prevail, we may count on a future level of annual expenditures somewhere between seven and eight billion dollars. This is considerably more than

double the total cost of government in the decade before the depression.

The budgetary record of the past decade deserves some special scrutiny from the viewpoint of the general conduct of the nation's finances. That a regular current balancing of expenditures by revenues is sound financial policy will, I think, be generally accepted. It must be admitted, on the other hand, that a deficit is sometimes unavoidable—the result of some extraordinary combination of circumstances involving either a drastic decline of revenue or an overwhelming increase in expenditure. Generally it is war that brings about such a situation; but it is conceivable that a severe economic depression might be the cause. I think that we can consider a budget deficit unavoidable only after (1) all proper efforts toward economy in expenditures have been taken and (2) strenuous efforts have been made to add to the revenues, especially from taxation.

The foregoing are, I believe, sound principles, which few would be disposed to question. It will be worth our while to inquire how far these principles have been regarded in the recent conduct of our national finances.

In the late depression the United States government adopted the policy of spending ourselves out of the depression, "priming the pump", lavish expenditures for relief, especially by means of public works rather than the more economical method of direct relief. Whether this was sound policy is a fair question; also open to question is the policy of social and economic reorganization that has run parallel. But these questions are not part of the subject of my present inquiry. The fact is that a depressed economic condition of the country and the economic and fiscal program of the government tended to bring about a condition of falling revenues and rising expenditures, out of which have come the recent large deficits in the national budget. The question to which I now invite your attention is not whether governmental policies causing a deficit were sound, but to what extent the deficit may be regarded as unavoidable.

When, on December 2, 1929, President Hoover presented to Congress his budget for 1931, the magnitude of the coming depression was not foreseen, and the question of a deficit was not considered. The President announced that "our estimated

expenditures for this and the next year are well within our expected receipts."

A year later the President was compelled to forecast a moderate deficit ($190,000,000) for the then current year, 1931. This he did not consider alarming, especially in view of the very large surpluses of recent years. He foresaw a balanced budget in 1932. He took occasion to warn Congress against entering upon new government activities involving cost but did not see the necessity of proposing new tax legislation. As we now know, the event was destined to prove his 1932 forecasts altogether wide of the mark. We may criticize Mr. Hoover for an optimism not justified by the situation in December 1930, but no blame can attach to his fiscal policy once his estimates were accepted.

In the budget message of 1933 (presented to Congress on December 7, 1931) there is recognition of the disastrous effects of depression upon the nation's finances. The deficit of 1931 was now a historical fact, and large deficits were evidently in store for 1932 and 1933. The budget message contains this paragraph:

> We can not maintain public confidence nor stability of the Federal Government without undertaking some temporary tax increases. It is obviously impossible to impose a degree of taxation which will balance the budget for the current fiscal year (1931). We should endeavor by increase of taxes and rigid curtailment of expenditures to balance the budget for the next fiscal year, except to the extent of the amount required for statutory debt retirements. We should assume its balance, including statutory debt retirements for the fiscal year following.

To carry out this purpose the President recommended taxes to raise $390,000,000 in the fiscal year 1932 and $920,000,000 in 1933.

A similar attitude is shown in the budget message for 1934 (presented December 5, 1932). Faced with increasing deficits, the President urged continuation of the provisions of the Economy Act of 1932, together with some further reductions in expenditures, and proposed additional taxation to raise $492,000,000 in 1934 and balance the budget, except for debt retirement. He stated: "I can not too strongly urge that every effort be made to limit expenditures and avoid additional obligations, not only in the interest of the already heavily burdened taxpayer but in the interest of the very integrity of

the finances of the Federal Government." Of course the President knew that the conduct of the government's finances would be in other hands during the fiscal year to which this budget related.

The new administration came into power on March 4, 1933. The " New Deal " program was promptly set in motion, involving heavy expenditures entirely beyond the scope of Mr. Hoover's budget for 1934. By the time President Roosevelt presented his first budget message (January 3, 1934), for the fiscal year 1935, his program called for expenditures for the then current year, 1934, amounting to the colossal sum of $10,569,000,000 (not including debt retirement). The predicted deficit was seven and a third billions for 1934 and nearly two billions more for 1935. The President described the situation in these words:

> Therefore, the total debt, if increased by the sum of two billion dollars during the fiscal year 1935, would amount to approximately $31,834,000,000 on June 31, 1935. It is my belief that so far as we can make estimates without present knowledge, the Government should seek to hold the total debt within this amount. Furthermore, the Government during the balance of this calendar year should plan to bring its 1936 expenditures, including recovery and relief, within the revenues expected in the fiscal year 1936.
>
> Let me put it another way: The excess of expenditures over receipts during this fiscal year amounts to over 7 billion dollars. My estimates for the coming fiscal year show an excess of expenditures over receipts of 2 billion dollars. We should plan to have a definitely balanced Budget for the third year of recovery and from that time on seek a continuing reduction of the national debt.
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> This excess of expenditures over revenues, amounting to over 9 billion dollars during 2 fiscal years, has been rendered necessary to bring the country to a sound condition after the unexampled crisis which we encountered last spring. It is a large amount, but the immeasurable benefits justify the cost.

Yet, except for incidental reference to certain tax measures then under consideration, estimated to produce altogether some $200,000,000, this budget contains no suggestion for additional taxation and on the economy side only the recommendation of further reduction of salaries of government employees.

In his budget message for 1936 (January 3, 1935) the President called attention to the fact that in the year 1934

the revenues had about balanced the "general" expenditures, leaving the four and a quarter billions of emergency expenditure responsible for the year's deficit. It was apparent that the President's hope of a balanced budget in 1936 (expressed a year before) was not to be fulfilled. Instead, the budget faced a deficit of four and a quarter billion dollars for 1935 and nearly four billions for 1936. In the face of this situation, no new economies were suggested—only the continuation of certain economy provisions already in effect. And beyond the recommendation that certain internal revenue taxes, due to expire in June and July, be continued, along with the three cent postage rate, there is no disposition to propose taxation. In the words of the message: "I do not consider it advisable at this time to propose any new or additional taxes for the fiscal year 1936." It will be recalled that, since the date of the last budget message, the Revenue Act of 1934 had been enacted. But its results were included in the estimates now presented.

The budget message for 1937 (January 3, 1936) took a most congratulatory tone. It presented estimates—soon to be shown surprisingly wide of the mark—for the expenses and deficit of the current year, 1936. It stressed the predicted balance of the "general" budget for 1936, except for debt retirements. Actually the year 1936 was destined, only six months later, to show a deficit even in the "general" budget of more than a billion dollars and a total deficit of four and a third billions. As to 1937, the President predicted a balanced budget in these words: "The state of national recovery is such that receipts from prevailing tax sources on the basis of present rates appear adequate for financing the ordinary operations of the Government in 1937, including service on the public debt; and no new or additional taxes are proposed." In connection with the forecast of the future occurs this remarkable paragraph: "Our policy is succeeding. The figures prove it. Secure in the knowledge that steadily decreasing deficits will turn in time into steadily increasing surpluses, and that it is the deficit of today which is making possible the surplus of tomorrow, let us pursue the course that we have mapped." I venture to suggest that here is not breathed the spirit of sound finance.

The budget for 1938 (January 5, 1937) is of the same general tenor. Although since the last budget message, the Revenue Act of 1936 had been passed, it was now apparent that the current fiscal year 1937 would show a deficit of more than two billion dollars. Actually it was destined to be $2,707,000,000. Nevertheless, without suggestions of economy or new taxation, the President predicts a balanced budget in 1938, including provision for the statutory debt retirements. This estimate was quickly revised on account of an increase in the sum asked for " recovery and relief ", making the 1938 budget barely in balance (a surplus of $37,000,000) without provision for debt retirement. A complete balance was predicted for 1939.

Since then the estimates for 1938 have been twice revised by presidential statements. The latest statement, that of October 18, 1937, now predicts a deficit of $695,000,000, without provision for debt retirement. The changed situation is due chiefly to recognition of the over-optimistic prediction, in January, of the yield of income and social security taxes.

In the light of this analysis of recent budgetary policy, it is not easy to regard the deficits of 1932-38 as entirely unavoidable. Without raising the question of the soundness of the government's economic policies, one can scarcely avoid the conclusion that economy in expenditure has not been the rule, that taxation has not been called upon to contribute as it should, and that, during a part at least of this period, the budget has not been managed with entire regard to established principles of sound finance.

REMARKS BY THE CHAIRMAN

DR. W. RANDOLPH BURGESS: Thank you, Professor Fairchild.

We now proceed to the discussion of the subject matter of these excellent papers.

The first speaker in the ten-minute discussion is a graduate of Yale University and the Harvard Law School. He comes from Ohio, and is a partner of the firm of Taft, Stettinius and Hollister, of Cincinnati. He is known to us chiefly for his distinguished service for three terms as a member of the House of Representatives Committee on Currency and Banking.

We have great pleasure in calling on Mr. John B. Hollister.

DISCUSSION: THE NATIONAL BUDGET OF THE UNITED STATES

JOHN B. HOLLISTER
Former Congressman from Ohio
Partner of Taft, Stettinius and Hollister, Cincinnati

NOT having had a chance to study Professor Fairchild's address before reaching here this morning, the few remarks that I had intended to make in opening this discussion may not perhaps be entirely responsive to everything he has said.

I find myself a little in the position of the young student who took the "cinch" course in Old Testament History—took it because for five years in the annual examination there had been a question concerning the names of the Kings of Judah in order. That counted fifty per cent and if he got the answer correct, he would pass. He was somewhat dismayed to find as the chief question in the examination, "Distinguish between the major and minor prophets." He wrote in answer: "Far be it from me to distinguish between such great and wise men, but the Kings of Judah in order are as follows."

A budget has been defined as a fiscal plan to balance expenditures against income. Stated thus simply, there is no difference between a budget for a government and for a person. Incidentally, the government seems to have as much trouble in meeting its budget as some of us personally have in meeting ours.

However, a government budget is a highly complicated thing from the point of view of preparation and from the point of view of administration, particularly in a form of government such as ours, where the executive branch, theoretically at least, does not control the legislative branch. It is the duty of the executive to prepare and present a budget that can be understood by everyone. It is the duty of the legislature to examine it, change it where it sees fit, and adopt it. Then it again becomes the duty of the executive to admin-

ister that budget and make a clear accounting of it. That part of the work is attended to by the chief executive in public utterances and through the treasury in making its accounts and statements.

We must make Congress responsible if it exceeds a proper budget as presented, and make the President responsible if he does not present the proper kind of budget or fails to account for it properly. Unless the executive presents the budget clearly, so that it can be grasped easily, and accounts for it clearly, so that all items of expenditure can be understood, it is impossible to hold him responsible. Unless we can place responsibility for these functions where it belongs, we are not going to be able to change the existing alarming situation.

I want to make a few comments today on some of the improprieties in the form in which the budget is submitted and in the methods of accounting for it.

Professor Fairchild examined in considerable detail the difference between the regular and emergency budgets. What you must keep in mind is that early in the budgeting of the present administration, the great majority of new expenditures were thrown into the emergency budget. Admittedly, there was an emergency and something had to be done about it. Extraordinary expenditures were necessary, and these were carried outside the regular budget. Then, as enlarged expenditures were demanded by the regular departments, they were carried into the emergency columns, apparently so that the "regular" budget would not show such a great increase over normal times.

The tendency has now been reversed—many of the "emergency" items have become the regular thing and are placed in the regular budget. Discretionary funds have been given to the President which he may switch back and forth, and it has become almost impossible—certainly for the layman—to find out what expenditures are for what purpose, or to make comparisons with other years.

Professor Fairchild has pointed out the concealment of the fact that large sums of money used for current expenses are really the repayments of some of the funds previously loaned by various governmental agencies, the money for which had been borrowed from the treasury and for which the treasury

had to raise the money by taxes. At the time these sums were borrowed, they were called " recoverable assets " and the argument was made that they should not be considered as current expenditures because they would soon be repaid. However, when the time comes to pay these sums, instead of making the announcement that these are the sums which unbalanced the budget in the past, we call them general receipts, put them in the general fund, and they reduce the spread between receipts and expenditures, thus showing a smaller deficit.

No reference has been made this morning to the guarantee of obligations. Where private finance is concerned, plenty of stress is placed on obligations which are guaranteed, for they have a serious effect on credit. Certainly the Securities and Exchange Commission insists on such things when it comes to a private corporation.

Our government is the guarantor of principal and interest of some $4,700,000,000 of obligations. These ought to be accentuated by the treasury rather than put in fine print in the complicated monthly treasury statement which is our only way of following these things. You need a fine-tooth comb and a magnifying glass to dig them out.

These are obligations which some time must be met, and while there will be substantial recoveries, everyone knows that there will be enormous losses in the $3,000,000,000 of Home Owners Loan Corporation bonds and the $1,500,000,000 of Federal Farm Mortgage Corporation bonds which the government has guaranteed, and a large part of which it will some time have to pay.

Another item to which attention should be given is that of currency manipulation. I am not talking about the effect of that on the general economic situation, but on the public expenditure. When gold was devalued, it is true that the greater part of the so-called " profit " was put into the stabilization fund, which is secretly administered and therefore nobody knows what has happened to it, but a certain amount of this paper profit went into the general fund and was spent.

It is also true that we are buying silver steadily and we now have more than $1,300,000,000 of silver certificates outstanding. We buy it at a certain price and issue it as silver certificates at a higher price; the difference is a sheer profit

for the government, and I defy the average person to dig this out of the treasury statement.

The Social Security Fund is another matter which is perhaps the most serious defect in present governmental accounting. Under the Social Security Act, taxes are collected by the treasury. They are then paid into a special fund which in turn is invested in some particular kind of government obligations issued for that purpose by the treasury. These funds thereupon lose the trust impress placed on them when gathered for a special purpose, and they become general funds to be spent by the treasury for general purposes. The trust impress is placed on the bonds which are carried in the fund. The September 30, 1937, Treasury Statement shows $390,000,000 of 3 per cent treasury notes due in 1941 and 1942, known as the Old-Age Reserve Account Series, and $457,000,000 of 2½ per cent certificates of indebtedness due next June, known as Unemployment Trust Fund Series. All we have to meet future obligations, to those expecting to be looked after when old age and unemployment occur, are the promises of the government to pay itself. The taxes which have been collected for this purpose have been in turn spent and will continue to be spent unless the Act is changed. It is true that the Act requires the treasury to handle matters in this way, but the treasury ought to make clear what is happening and ought to point out the fact that, if it were not for the social security funds which are coming in, the spread between receipts and disbursements would be even greater than it now appears to be.

It seems to me that the only way we will save the situation is to bring home to the people exactly what is happening. We are not going to be able to bring home to them what is happening unless there is some clear presentation of the facts and unless the chief executive is willing to face the situation squarely and explain to the people in simple words, that any layman can understand, the chief items of receipts and chief items of disbursements, distinguishing between those which are ordinary and those which are truly emergency, between those which are matters of bookkeeping and those which are true revenue receipts and true expenditures.

The budget itself is an enormously complicated thing. Outside of the budget director and a few assistants, I do not believe

anyone has a broad grasp of the whole picture. I do not believe that the executive and the treasury have a full grasp of it. I do not believe that the Appropriations Committee of the House, or of the Senate, has a full grasp, because these committees are divided into a number of subcommittees, each taking up one department. Each subcommittee knows the expenditures of its own department and checks them carefully, but no one on the Appropriations Committee in either the House or Senate knows all about all of them, and the result is a sort of hit-or-miss thing. Each chairman of a subcommittee jockies his part of it through his house, and after additions are made—seldom subtractions, practically always additions—the House committee and the Senate committee sit together and agree on a bill which is nearly always an increase in the particular budget, and that is put through. So when the total appropriations are made and adopted, the total is whatever it may happen to be and has no reference, perhaps, to the original totals submitted.

If we are going to have responsibility, we must understand what Congress is doing. To accomplish this, there is a duty on the part of the executive to present a clear budget and, when he presents it, to defend it and not be in the position we are in today of having the executive call a special session of Congress to pass laws which will put out of balance by several hundred millions the budget he presented.

If the executive defends his budget and accounts properly to the people through his own statements and through his right arm, the Secretary of the Treasury, we are going to be able to fix responsibility for budget excesses in the future.

Remarks by the Chairman

Dr. W. Randolph Burgess: Among the required readings of the banker or the businessman in this country, almost second to the daily paper, comes the London *Economist.* The editor of *The Economist*, Sir Walter Layton, who is one of the Trustees of the Academy, has appeared before us on a number of occasions.

We are fortunate today in having with us his associate, Mr. D. Graham Hutton, assistant editor of the London *Economist* and former lecturer at the London School of Economics, who will now continue the discussion.

DISCUSSION: THE NATIONAL BUDGET OF GREAT BRITAIN

D. GRAHAM HUTTON

Assistant Editor of *The Economist*, London; former Lecturer, London School of Economics

I must confess to a certain embarrassment at the praise given to those responsible for the financial prestidigitation in my country. As a consequence of having to follow the results of their practice and watch the rabbits emerge from the hat, I am not quite as happy as some earlier speakers seem to be about English finances; and for these reasons:

In the first place, if you look at the remarkable tables produced by Professor Lutz, you will find there has been a considerable change-over in the composition of the British budget during the last eight to ten years. Not only has that change-over been observable as between direct and indirect taxation, but there has also been a hidden turnover between budgetary and non-budgetary expenditure. That is to say, there is at the present time a considerably greater amount of government-controlled expenditure, apart from the revenue-based expenditure, through non-budgetary channels today.

A very interesting study has been made by Professor N. F. Hall. He shows that a considerable number of important funds and institutions are controlled through the government departments, beside those of the treasury and exchequer. The Auditor and Controller-General is not concerned with all of these. You find that the government today has control over about a hundred million pounds' worth of expenditure a year which, ten or fifteen years ago, would certainly have been covered in the normal ordinary budget. New funds have been set up to administer subsidies, et cetera, and the balances of these funds can be used in the medium- and short-term money market, and are so used. Their accounting years do not run for the same period as do the budget years; and all sorts of financial prestidigitation is possible to the tune of some millions

of pounds *per annum*—and you are not even sure which *annum* it is.

A second feature, rather puzzling to the English student of his own finances, is that a very great increase has taken place in the percentage of national expenditure passing through the budget. Professor Lutz touched on that in passing, but the percentages are really very striking. It runs something like this, at a rough computation: From 1904 to 1910, for instance, you get total budgetary expenditure at 7.1 per cent of the national income, rising, as Professor Lutz said, to 18.1 per cent in the estimates for 1937. If you take that together with the local expenditures of local authorities in England, you find that a much greater amount of what one might call corporate government finance, that is both central and local government, is now passing through annual budgets. Not all the items in these annual budgets, however, are amenable to ordinary public or parliamentary scrutiny. There is a considerable opportunity for diversion in local expenditures from one branch of expenditure to another within one and the same year. This is not possible in central expenditures for statutory reasons.

A third point is that the composition of the national debt has changed very much in the last seven years, together with the reduction in the rate of interest on that debt. Thus the charge of carrying the annual service on that debt has been reduced by 33⅓ per cent. This has set free possibilities of expenditure in other directions. At the same time, however, a problem has arisen which was not foreseen and for whose solution no provision can yet be made. As Professor Lutz's tables show, we have now funded really one-half the debt; but the unfunded debt has changed from remote-dated to near-dated debt. This has been achieved by bringing the dates for the falling-due of the national debt very much nearer to the present; so that, whereas twenty years ago or before the War a smaller percentage of the unfunded national debt was falling due farther ahead, today a much larger percentage is falling due much nearer ahead. You will at once observe the importance of movements in the rate of interest. For these movements, as far as one can judge, no provision whatever has been made. Yet it is a potential source of embarrassment. For if the rate of interest on short- and long-term debt moves up 1

per cent, the change will greatly embarrass the budget, as debt has to be "converted upwards". The rate of interest has already moved up over a half a point in eighteen months. What if it moves up 1 per cent or 1½ per cent? Already seven years have gone by since the first incidence of the financial depression on English finances. It is quite possible, in another five years for example, that a considerable proportion of debt will be falling due at much higher interest rates. No provision has been made for that.

The fourth point is the financing of our defenses, which Professor Lutz quite understandably passed over. But you will not expect me to pass over it.

Defense borne by the normal budget has increased by 90 per cent in three or four years. In addition to that, England now has an extraordinary budget. We do not say it is an extraordinary budget; but it is one, nevertheless. The total has risen from 107 millions in the ordinary budget to 200 millions or, to be precise, 198 millions *plus* an unknown quantity of supplementary estimates.

In addition, there is 80 millions borrowed, not borne by revenue. That 80 millions is for the "capital" purposes of defense. Such "capital" purposes are, we presume, battleships, and I suppose a certain amount of mechanization for the land forces; but by far the greater part is for factories and permanent capital works like aerodromes and various other undertakings in connection with the armament program.

That, of course, is an extraordinary budget. But that is not the point that concerns English economists. The point that worries them is this: not only is a considerable proportion of the increase in normal revenue (covered by expenditure) of a rapidly obsolescing kind, but the 80 millions which is borrowed in addition to that is also of a very rapidly obsolescing kind. And no provision is being made to meet the incidence of this second type of "capital" obsolescence during the next five years.

To take an obvious example—an aircraft factory and the aircraft it turns out are both obsolescing; in the case of aircraft, 33 to 50 per cent *per annum* when they are finished. Battleships take very much longer—15 to 20 years' life—but the cost of three or four refits in that period is almost three times

the cost of the battleship; and no provision is being made for the incidence of this kind of obsolescence on future budgets, or for the retirement of any of the capital borrowing of 80 millions for five years. That sum amounts to 400 millions, or 2 billion dollars.

The future incidence upon the budget of this unknown obsolescence factor is causing British economists some perturbation. It is possible that the national income will go on rising in terms of money for a considerable time. I think, in fact, it will in the United Kingdom; but the national income is already bespoken to the extent of 5.4 per cent in the current year for defense purposes alone, as compared with 3 per cent two years ago, and 2.6 per cent five years ago. It has more than doubled. This kind of unknown incidence is very difficult to budget for on the revenue side in future; and we concluded in *The Economist's* last Budget Supplement that something like another hundred million pounds of revenue must be found somewhere, on a budget of only 800 million pounds' revenue, in order to cover all the normal, orthodox financing of the defense expenditure and of other expenditures. I do not know where the other hundred millions is going to be found. If you look at income tax history, you will find that the yields of income tax and super tax have risen, but not in proportion to the rates of tax; nor has the yield per penny of tax risen to anything like the same extent. We seem to be reaching the upper tax limits and the lower limits of those who can qualify for paying income tax. It is difficult to see what else can be done in that direction; and in the customs revenue it is difficult to see what can be done. If we put duties up for revenue purposes, they will certainly become protective, and we shall not get the revenue.

I want to conclude, however, with two general observations quite apart from the British budget. The first is on the French budget. There you notice at once the difference in the French and British budgets during the last six years. The percentage of the normal French budget falling to the service of the national debt is 50 per cent. In the case of Britain it has been reduced by 33⅓ per cent, from about 45 per cent down to about 24 per cent—something like that. This reduction, of course, is beneficial as long as the authorities can control

the money market and keep interest rates down. The French, however, owing to the export of capital, have not been able to get their money market fluid, reduce their interest rates, and so convert the interest rate on the national debt. The main problem is the problem of carrying the national debt, not so much as carrying the extraordinary budget, defenses, telegraphs, railroads, etc.

The next point is common to all of us—French, British and American. We have all devalued our currency; but there has not been a movement in prices toward the equilibrium that you would normally expect from a 40, 42 or 45 per cent devaluation. Is it not to be expected that, if you devalue your money and get the money market fluid and alter the whole relation between capital and income, your budget should tend to move in the same direction? I hope that some American economist will enlighten me today why Americans seem so terrified at the proportions of their national debt. I am surprised when I compare our country's finances with yours and find that it takes twenty months of our national income to buy up our national debt and only eight months of yours.

Remarks by the Chairman

DR. W. RANDOLPH BURGESS: We thank you, sir for that very pleasant thought. We have almost half an hour remaining for discussion. For purposes of this discussion, we have a five-minute rule, so there may be an opportunity for a number to speak, or, if you prefer, to ask questions of those who have spoken.[1]

[1] Space limitations make it impossible to print in these PROCEEDINGS the interesting discussion by several members who spoke from the floor under the five-minute rule.—ED.

PART II

THE FUTURE OF THE FEDERAL BUDGET

INTRODUCTORY REMARKS *

WESLEY C. MITCHELL *Presiding*

Professor of Economics, Columbia University
President of the Academy of Political Science

IN opening this afternoon's session, it is fitting to recall that the Academy hoped to have another presiding officer. Those of you who received the earlier edition of our program noticed that the Honorable Ogden L. Mills, than whom there could be no fitter chairman for a meeting considering the federal budget, had promised to take charge. Through the untimely death of Mr. Mills, former Secretary of the Treasury, the country has lost one of its most valuable citizens and the Academy of Political Science has lost one of its wisest counselors.

At the morning session we had reviews by three distinguished authorities of recent changes in the national budgets of the three great democracies of the present day. Our speakers gave us illuminating accounts of the extraordinary expenditures that the Great Depression forced upon the governments of Great Britain, France and the United States, and of the various devices that these governments used to meet these additions to normal budgetary requirements which were already heavy.

With these reviews in mind, we are now to hear the future of the federal budget in the United States discussed by speakers as eminently qualified to treat their several topics as were the speakers at the morning session.

I have the pleasure of introducing first Professor Alvin H. Hansen, formerly of the University of Minnesota, then of the Department of State, now of Harvard University, who will speak upon "The Consequences of Reducing Expenditures". Professor Hansen!

* Opening of the Second Session of the Fifty-seventh Annual Meeting.

THE CONSEQUENCES OF REDUCING EXPENDITURES

ALVIN H. HANSEN

Professor of Political Economy, Graduate School of Public Administration, Harvard University

THE current fiscal year presents a crucial stage in the development of industrial recovery in this country. For several years the government has been pouring out funds into the community in excess of the funds which it has taken back from the community in the form of tax receipts. The current shift in deficit financing represents an order of magnitude sufficiently large to have very considerable repercussions upon the economy. Whereas, in previous years the net contribution made by the government to the growth in community expenditures amounted to some three billion dollars, in the current fiscal year the balance of governmental receipts and expenditures is expected to effect some net contraction, when account is taken of the social security taxes. It is this sudden shift, its implications and its consequences, to which I wish to direct your attention.

In order to appraise the consequences of reducing governmental expenditures it will be helpful, I think, to consider the character of the recovery thus far achieved in the United States.

Everyone will agree that this recovery has been on many counts a very unusual and exceptional one. In many respects it does not follow the pattern of recovery movements in the past. One could differentiate it from earlier recovery periods in various ways. I wish, however, to direct attention to one special characteristic which I regard as of primary significance, particularly with respect to the topic here under consideration.

The recovery which we have been experiencing in the United States thus far may be characterized as a consumption recovery. By that I mean that the expansion in income, employment and output has been based mainly on a rise in consumption. There has occurred, to be sure, a very considerable increase in real

investment, but investment has for the most part followed consumption; it has not, except in limited degree, led the way.

Let us consider very briefly the history of the revival to date. It was of course quite impossible for any sustained recovery to get under way until the banking system had been placed in a position which commanded the confidence of depositors. Without this rock-bottom foundation the economy could only sink deeper and deeper into the morass of a cumulative deflation. Moreover, the change in the foreign exchange value of the dollar definitely removed a powerful price depressant and brought about an internal readjustment of prices in favor of agricultural and raw material producers. This realignment materially improved the balance in the general price structure and in the relative purchasing power of different branches of our economy. On the basis of these two changes, the reconstruction of the banking system and the realignment of the internal price structure, a foothold was secured from which recovery could go forward.

The speculative inventory boom of the second quarter of 1933 quickly collapsed at the mid-point of the year. It had been caused mainly by the prospective rise in prices indicated by the new monetary policy and partly by the prospective rise in costs indicated by the N. R. A. A fresh start on a more modest scale, but also on a firmer foundation, was made at the turn of the year. Two factors were of primary importance. The first was the rise in the demand for durable consumers' goods of which automobiles was the most important single category; the second was the income-stimulating expenditures of the federal government. Both developments indicated a rise in the rate of consumption—the first in the durable goods field, the second in the sphere of current consumption needs.

The prolonged deflation had restrained many people from buying new automobiles, household appliances and other durable consumers' goods. Instead they had chosen to hold in suspense, for subsequent use, available or potential purchasing power. The improved psychology following the banking and monetary reforms combined with the growing need for replacements—a need more and more urgently felt as the existing stock became increasingly obsolete—released an accumulated backlog of consumers' demand for durable goods. In large

measure this new demand was financed by an expansion of installment credit. Thus it was consumption and not investment which led the way toward revival. As the purchase of durable consumers' goods increased, new investment in plant and equipment had indeed to be made not only in the industries directly supplying these products but also in all the underlying contributing industries from steel to machine tools.

Coincident with this development with respect to durable consumers' goods, the government began on a large scale to pour out new funds into the community—funds which went directly into the hands of needy consumers and which at once swelled the volume of consumer purchases. This in turn forced necessary renewals and replacements and finally some expansion in capital expenditures. Thus, the initial rise in consumption caused an increase in real investment and this in turn, through the ensuing increase in employment and payrolls, lifted still higher the level of consumption.

The demand for durable consumers' goods rose through 1935, 1936 and early 1937 to ever higher levels, carrying with it an expansion of investment, income and employment. Governmental net contributions to consumption rose sharply from the close of 1933, pumping new funds into the consumers' markets at the rate of about three billion dollars per annum. Finally in 1936 the soldiers' bonus lifted the stimulating expenditures to still higher figures. In the meantime, beginning with early 1935, another major durable goods industry—residential building—began to make a belated, but halting and limited, contribution to recovery.

For our purposes it is not necessary to fill in the entire picture detailing the recovery to date. It is sufficient to press home the point that this recovery has been peculiarly one based on a rise in consumption. Some considerable increase in real investment did indeed follow, as indicated, but I think it is common knowledge, and quite generally agreed upon, that throughout the upswing period new investment in plant and equipment has been geared rigorously and narrowly, in a quite unusual degree, to the immediate requirements of consumption. Business men have avoided as much as possible long-term capital commitments. They have cautiously restored and expanded their production facilities to the bare limit severely

required by the current and immediately prospective level of consumption. There were of course exceptions, but taking a general view of the matter, the statement just made may be fairly said to describe the significantly outstanding characteristic of the current recovery.

In sharp contrast with the recent development is the record of recovery movements in the past. I do not wish on this occasion to enter into the controversy regarding the order of precedence of consumption and investment in the very first initiating stage of revival. On purely *a priori* grounds there are strong reasons for believing that in a predominantly non-interventionist economy the upswing is likely to be initiated by new investment, with consumption following behind as income and employment rise. On balance the historical record supports this view. Especially is this true if one rules out the "terms-of-trade" argument, which has the serious defect of viewing the problem from the standpoint of a single section of the world economy. But whatever the facts with respect to the initial period, I think a consensus can be reached on the proposition that former recoveries have typically been carried forward on a wave of new investment which was *not* narrowly gauged by the current and immediate level of consumption purchases. Large bold projects looking far into the future have typically been undertaken in the upswing period. They were launched, not on narrow calculations with respect to current demand. Daring investments based on important technological advances, on innovations, cost-reducing improvements, and on the discovery of new resources, were projected in the faith that the forward march in capital accumulation and productive equipment would itself call forth an enlarged purchasing power. Had the rate of investment always been narrowly geared to the current rate of consumer demand, we should never have witnessed the material progress achieved in the nineteenth century.

Investment in upswing periods has typically *led* and not followed consumption. It was of the very essence of the boom that a great forward thrust was made into new frontiers of technical equipment and productive power. The developments of the boom had no relation to the then prevailing level of consumption. They were based instead on future expectations, on

a dynamic conception of economic life. Revolutionary changes in technique, innovations in productive processes, the development of new products, the exploitation of new resources—these are the factors that, from time to time, have caused important capital expenditures. The industrial revolution, the waves of railway construction, the booms based on electricity and automotive power had no relation whatever to the current volume of consumption.

"Ah yes", someone will say, "but that's just the rub." Always these bursts of investment have spent their force and left the economy prostrate and depressed. New investment had indeed lifted consumption, income, output and employment to higher levels, but these levels were never for long maintained. The advance had come by spurts and the bucket of capital formation, to borrow an apt simile from Spiethoff, had been filled to overflowing. It was now only necessary to keep it full. Investment had indeed led the way but the violent forward leap too frequently ended in disaster. Sustained recovery, yes; but ultimately at the high cost of instability. And, it will be asked, is it at any rate not true that a recovery such as the present, in which consumption has led the way, and investment has followed after like a dutiful handmaiden, is much to be preferred to one in which investment, like a dashing but reckless knight, goes forward to conquer worlds so vast as to preclude peaceful assimilation into a stable and settled society?

We are now coming to the gist of my thesis. Unfortunately, a recovery resting almost exclusively on a rising tide of consumption can go forward only so long as the consumption stimulus is applied. Worse yet, it cannot even maintain the level reached, once new funds are no longer poured into consumers' markets. For it is a peculiarity of business activity, geared closely to consumption demands, that once consumption ceases to rise, there are forces at work causing contraction. Thus, it is not true, as some have asserted, that the current reversal from large income-creating governmental expenditures to a cessation of such stimuli will at the worst have no more serious consequence than a tapering off of the trend of income, employment and business activity. In a peculiar sense a recovery based on consumption cannot stand still.

The analysis which I have just made is, of course, merely an application to the current phase in our recovery of the familiar principle of acceleration. But there is one aspect of the matter which I think has not been adequately recognized by economists. As I have elsewhere[1] stated, the principle of acceleration has probably played a minor rôle in the past in the causation of the turning point from expansion to contraction. And a main reason for this is that in the typical upswing movement the rate of investment has proceeded in large part quite independently of the rate of consumption. On the other hand, what needs to be strongly emphasized is just this: if the recovery movement is of such a character that the rate of investment is closely geared to the rate of consumption, it then follows that the principle of acceleration operates with full force, subject, however, to certain qualifications with respect to variations in the degree of excess capacity, the age of the capital equipment, et cetera. These qualifications at the moment probably weigh on the whole more heavily on the side of contraction than on the side of expansion. Therefore, it may be asserted that substantially the full implications of the principle of acceleration must be taken cognizance of in the situation immediately confronting us.

The implications of this principle, once firmly grasped, are very clear. So long as consumption is rising there is need for renewals and for more plant and equipment to satisfy the growing consumption demand; but as soon as consumption flattens out there is no need for any new investment in plant and equipment. To supply the current level of consumption one has only to maintain intact the existing equipment. The output of investment goods, therefore, falls to the level of mere replacement which indeed in many lines may, for a considerable period, be wholly deferred, especially if existing equipment is relatively new. It follows that as consumption flattens out, net investment ceases and there remain only repairs, upkeep, and some essential replacement. As net investment ceases, employment declines in the capital goods industries, and in the succeeding period consumption itself, from having flattened out, begins actually to fall off. This is the dilemma which

[1] See my article on "Harrod on the Trade Cycle", *Quart. Jour. Economics,* May 1937.

confronts a recovery reared on the stimulus to consumption. Such a recovery can proceed no farther than it is pushed. It has no momentum of its own. It has no inner power to complete its own development.

We are currently witnessing a rapid shift in income-creating expenditures both public and private. The props which have been lifting the level of consumption are being withdrawn. The automobile boom has tapered off. We are moving toward a saturation point in installment sales. The government stimulus to consumption is in process of being completely withdrawn in a dramatic reversal from a plus of three billion dollars to a minus of four hundred million dollars within a single year. The full force of this sudden change upon our recovery has perhaps not been adequately appraised. One explanation for this is probably that the public has fixed its eyes on the formal balancing of the budget. And since this is not yet balanced, the impression is abroad that the government is still lavishly spending more than it is taking from the public in tax receipts. But this is looking at the form and not the substance. From the standpoint of consumption stimulation, the " economic budget ", so to speak, in contradistinction to the formal fiscal budget, will already in the current year, according to the President's estimates, be more than balanced. In other words, when we take account of the social security taxes, including both old-age and unemployment insurance, it is found that the government in this fiscal year is actually exerting a deflationary pressure on the volume of consumption.

I do not draw the conclusion that there is inevitably impending a major recession. But I do say that if we are to avoid some considerable recession, either consumption must be pushed forward or else investment must be pried loose from the narrow limits imposed by the immediate requirements of the existing volume of consumption.

We cannot lightly assume that consumption, unaided by government spending, will of itself continue to rise. Unsupported by the government it can go forward only on the basis of a further extension of consumer credit. But this involves obvious difficulties. There is, however, one important thing which could be done quickly, and without disturbing the balancing of the fiscal budget. We could remove the deflationary

pressure currently exerted by impounding the old-age insurance taxes into a Reserve Account. We could place this Account on a pay-as-you-go basis. This should be done. It is difficult enough to cope with recessionary tendencies in any case without inviting additional trouble; and there is no escape from the conclusion that the impounding of these funds adds strength to the deflationary forces.

But this is not enough. We cannot facilely expect that the recovery will just automatically complete itself. There is no assurance that business will surely carry on to a full measure of prosperity. For " carrying on " means that new investment shall no longer be starved as has hitherto been the case. Indeed, unless something positive is done, there is widespread evidence that the requisite investment will in point of fact not be made.

Many reasons have been assigned for the currently low level of new investment. There are those who are convinced that the basic cause goes very deep; that it is to be sought in a fundamental change which it is believed our social order is undergoing. It is said that we are passing through a transition period—the implications and significance of which history alone can appraise—a transition from a free economy to a controlled economy. The framework in which private enterprise is permitted to function is becoming more narrowly circumscribed. It is said that business chafes in the new " harness "; that like a " bucking broncho " it refuses to function until its old freedoms are restored. Thus, it is alleged, we are confronted with an irreconcilable conflict between business and government. Private enterprise, operating in a free market, can, it is said, function with a high order of efficiency and even with reasonably full employment. At the opposite extreme it is conceded that a highly centralized collectivism could command and direct the productive resources. But a hybrid economy, an economy which is neither free nor regimented, cannot, it is argued, function at anything like full employment. This limping hybrid system continues to rely on private enterprise, yet the motivating and energizing forces are dampened down and at times almost wholly suppressed. From this point of view, there can be no escape from a deadlock which can be broken only by driving on toward a completely

authoritarian state. The present recession is thus regarded as only a preliminary demonstration that a hybrid society, half free and half controlled, can succeed only to a very limited degree. Such a society, it is said, quickly gets all snarled up in its own processes. Every attempt at a solution involves it in a maze of contradictions. Every artificial stimulant saps its inner strength. Every new measure conjures out of the ground a hundred new problems.

It is safe to say that a fairly large part of the American public subscribes to the thesis just stated. It appears to be the view of a very considerable section of the business community. It is, of course, the view of the communist and the thoroughgoing collectivist. What the verdict of history will be depends upon a great many imponderables. At any rate I do not regard the indicated development as a necessary or inevitable one.

Stepping down very far from this rather abstract level, we encounter a much more practical bit of speculation—one concerned with more immediate considerations. The current recession, it is said, is due to certain *specific* governmental interferences which, even granting most of the basic aims of the New Deal, could have been avoided. The regulations of the security market, the undistributed profits tax, the capital gains tax, it is alleged, have had the effect of rendering the capital market quite impotent to perform its necessary function. It is this that has prevented the desired volume of new investment. The budget deficit is regarded as having been continued over an unnecessarily long period of years. Governmental issues have supplanted private issues in the capital markets. Investors have become accustomed to holding assets which offer an exceptional measure of liquidity. The capital market has lost its capacity to serve enterprise. It can no longer function as the medium through which the stream of savings is able to find an outlet in ventures that involve considerable risk. The possessors of loanable funds have been driven to shelter, to high liquidity and security. The market regulations and the capital gains tax, it is alleged, have rendered the stock market so erratic as to preclude the issuance of new securities. Modification, but not abandonment, of the machinery of governmental control is, from this point of view, believed to be

adequate to bring about the necessary volume of new investment.

Such is the analysis which has recently preoccupied the public mind. No doubt it deserves careful consideration, particularly that concerned with the assumption of risk. Respecting the mechanism of the stock market, while it may indeed explain, in part, the jerky and erratic fluctuations in security price movements, it can never explain a sustained level of valuations. These ultimately rest, not on the character of the market machinery, but upon anticipations of future yield. From this standpoint it has not yet been demonstrated that the market has done much more than to correct an earlier inflated optimism based on the expectation of a continued rapid rise in the national income and in commodity prices.

Yet even though the market mechanism were perfected, there still remains a fundamental difficulty. We are compelled to face squarely the question of how far the stock market can perform its essential function of connecting the flow of savings with investment outlets, in a situation in which the desire for a high degree of liquidity alternates with an intense desire to speculate, and in which, moreover, so large a part of the investing public is regimented into like-mindedness under the influence of the ubiquitous forecasting services—the drill sergeants of the modern speculative community.

I turn now to something which is admittedly highly problematical and which raises many difficult problems. It may be that the particular manner in which the deficit has been managed, with reference to the composition of the federal debt, makes it peculiarly difficult for private investment to expand in the amount required for full employment. Business expansion beyond a certain moderate limit finally evokes demands upon the banking system whether in the form of loans or investments. As these alternative employments open up, banks begin to unload their governments. This depresses bond prices. If it is anticipated that long-term government bonds will fall still farther, renewed selling occurs. Thus there is danger that the interest rate as reflected by bond yields will rise far more rapidly than justified by the economic situation. The prospect that such a rise is imminent may prevent flotations and thus check expansion. We are thus caught in a dilemma. The more private investment expands the greater

the demands on bank credit; the greater the demand for credit the more banks tend to unload government obligations; with the prospect of higher interest rates there develops a scramble to sell long-term bonds; and finally, the disturbed conditions in the bond market render any further expansion of private investment difficult. Thus deficit financing through long-term bonds, in so far as such bonds are held by the banks, imposes a limit on the expansion of private investment beyond a fairly moderate amount. If this is true, we shall have to revise our views with respect to the assumed merits of long-term government obligations, at least in so far as fiscal operations are designed to play the rôle of a compensatory device.

I turn now to an even more fundamental matter. The failure of new investment in this recovery is due in large part to a tendency to push costs up higher than the level of income justifies. This is due partly to governmental policies beginning with the N. R. A., partly to corporate price policies and partly to labor policies. It is notorious that building material and labor costs have been pushed to a level that prevents the construction of new houses on a scale commensurate with current requirements. In addition to the uneconomic construction costs there is the current cost of borrowing. The 6¼ per cent rate offered under the government guarantee plan is high beyond reason in view of the abundance of savings and loanable funds seeking investment outlets. It is true that private funds can be obtained at somewhat lower rates, but it is not clear that even these are as low as the current conditions justify. Interest rates at all commensurate with the low rate on long-term government bonds are simply not available for residential construction. The various parts of the interest rate structure are not sufficiently closely interrelated. Each is locked up altogether too rigidly in a water-tight compartment. In an era of easy money, the rates at points crucial for new investment have remained at uneconomic levels. The capital market is organized to handle certain types of financing, but we have not succeeded, with all our easy money, in furnishing capital at low cost at many points where new investment is most needed.

In a larger way the problem of high costs ramifies into every nook and corner of our economy. It is partly a question, as I have said, of corporate price policies. Public utilities hesitate to risk developmental rates designed to tap potential

demand. Business through so-called fair-trade regulations and neo-monopolistic practices imposes a limitation on output and employment. In the case of the railroads the failure of a thoroughgoing program of rationalization together with high labor costs prevents investment expansion. In our basic industries there is danger that continued increases in wage rates may place our cost structure in a disequilibrium position with respect to the outside world. The administration, and with it public opinion, has never faced the utter fallacy of trying to boost income, output and employment by raising costs. The question may well be asked whether certain types of federal expenditures have not in large part had the effect of boosting costs when the real purpose was to increase income and employment. We have apparently yet to learn the lesson that high *wage rates* do not of themselves guarantee a high labor income and full employment. We have too often put the cart before the horse. The all-important desiderata are total income and employment. Had governmental expenditures been combined with a planned program of cost reduction, there might have followed an expansion of income and employment not only via a stimulation of consumption, but also via a stimulation of new investment. This program we have not adequately achieved, and now that the consumption stimulus is being withdrawn, the forbiddingly high level of costs renders it difficult for investment to hold back the receding tide. Thus we are left without the necessary volume of total expenditures, whether for consumption or investment, to carry us on toward full recovery.

This is the fatal error we have made. But I must not overstate the case. For there is one other consideration that troubles me and raises uneasy doubts whether, though we had managed our affairs ever so wisely, we should even so have been safely and securely on the road to full and sustained recovery. I refer to certain technological and other conditions which in part determine the volume of investment outlets. For it is not true, as is sometimes alleged, that technological conditions have been uniformly and at all times equally favorable for new investment outlets. Not every period can be characterized as a kind of new industrial revolution. The introduction of power-driven machinery was followed by a prolonged period of difficult readjustment. In a later age,

as the curve of railway construction eventually flattened out, it was discovered that there was no adequate ground for the easy optimism that plenty of promising investment possibilities would surely appear to fill the gap. In point of fact they did not appear in adequate volume, and so there ensued toward the close of the last century a prolonged period of secular stagnation. It is true that in the course of time technology gave birth to the electrical and automobile age and with it a new era of highway construction. Altogether these developments swallowed up vast sums of capital; but it is not difficult to see that this latter episode is nearing completion and, as has happened before, nothing else of equal magnitude has so far appeared above the horizon. Add to this the wholly new fact of a rapidly approaching cessation of population growth. Let the perennial optimist reflect on the enormous masses of capital that found investment outlets during the nineteenth century for no other reason than that the population of England quadrupled, that of Europe trebled, while that of the United States increased fifteen-fold. For these and other reasons we shall do well to ponder deeply the problem of the long-waves, or, if you prefer, the problem of secular stagnation, the magnitude of which may well, in the period which lies before us, quite overshadow that of the business cycle. Viewed against this background, governmental expenditures take on a new significance.

From being purely a cyclical compensatory device, designed to stimulate consumption, public expenditures may come to be used increasingly as a means of directing the flow of savings into real investment. In this connection it may not be amiss to note that the modern network of highways, unlike the old, is publicly financed and publicly owned. It is not difficult to see that a major change in the savings-investment process is already upon us. This implies, moreover, a substantial shift in the rôle of taxation and of public debt in the functioning of the whole economy.

Remarks by the Chairman

President Mitchell: I have the pleasure of introducing General Hugh S. Johnson, Former Administrator of the National Recovery Act, and even more widely known since his retirement from that post for various other reasons.

VESTED INTERESTS IN GOVERNMENT SPENDING

GENERAL HUGH JOHNSON
Former Administrator, National Recovery Act

MY assigned subject is "Vested Interests in Federal Spending". Difficult as it will be, because of my strong convictions to keep off other aspects of this critically vital subject of spending, I shall try to keep in this single corner.

Legally, except as they may be created by direct engagements, there are no vested interests in federal spending. Practically we have been investing classes with such interests at a slowly increasing rate from the Civil War to the World War. From the latter epoch to the New Deal, the rate of increase in vested interests went up slowly. Since 1933, the curve of increase has risen like a rocket. At least one third of the population seems now so clothed.

George Washington's kind of federal government cost this population $1.09 a head. In the seventy years to the Civil War, it did not rise above $2.50 a head. The Civil War left us our first great vested interest in governmental spending—the pension system. But, even with that, the cost of federal government per capita never rose above $8.00 until the World War.

That war left us a new crop of vested interests in bonuses, pensions and care of veterans. But from 1920 to 1932, including those and also payment of the war debt, we kept our per capita cost below $35.00. Now the lid is off—and perhaps permanently. The cost per head of the Washington government is now about $70.00 and as the depression recedes it continues to increase.

This amounts in actual spending to an increase over budget levels, before the new philosophies came in, to more than double the old bill for federal government—to the humanly inconceivable sum of five billion dollars a year or more for the "vested" interests, newly created in federal spending,

than in all functions of government, formerly considered legitimate, since the beginning of our history.

It could be considered with far less apprehension if any respectable opinion believed it could be continued without eventual collapse or complete remaking of our political and economic systems. I know of no such optimistic belief which is also respectable.

What is a vested interest in federal spending? It is a very definite thing. If a principle is once firmly established in government that, in any set of circumstances, any class of people or any particular area is entitled to some benefit, then in equal justice, any other class or area in the same circumstances can justly demand the same benefit. Vested means no more than "clothed with a claim of right" and you can hardly get away from the conclusion that any kind of class spending creates a vested interest in all persons in the same class.

The danger here comes not from acknowledgment of these secondary claims against the public purse. It comes from concession of the original claim.

Mr. Roosevelt went into office with no idea of changing the essential rights and obligations between government and its citizens. I sat in at the formation of the original New Deal. I speak from no conjecture. Except in two particulars, there was no idea of any new concept of the burdens and benefits of citizenship.

We were at such an extremity that, as an emergency principle, "nobody was going to starve in this country." Beyond this the only novelty—if novelty it were—was that farmers were somehow to be accorded a "benefit" on the portion of export crops consumed at home, equivalent to the tariff benefit long enjoyed by industry.

The country seemed to approve those departures and, except perhaps the farm promise which, after all, was an offset to a special tariff subsidy applied at our very beginnings, there was no purpose to change the fundamentals governing the duty of government to people.

But many of them are changed now—changed from cellar to garret. Even the Supreme Court went out of its way to settle a century-and-a-half old controversy and decide that the power to tax is not restricted to revenue raising to carry

out the specific constitutional federal functions. At last it is clear that it may be used for anything that promotes the general welfare. That can mean practically anything at all and it will probably be held to mean whatever Congress *says it means.* It had already been decided that the taxing power need not be restricted to the object of raising revenue. It is the power to destroy. If it can be used to destroy, it can probably be used for any lesser purpose—such as to punish, prevent, restrict and regulate anything within the now infinitely broadened scope of the taxing power. What I am trying to say is that relief in the future from increases in vested interests in federal spending, if any, will have to be found at the polls and not in the courts.

With so hastily sketched a background of recent fundamental relaxations of old restrictions, we can consider some of the precedents set up, in the past four years, to create new vested interests in federal spending.

First—relief. The 1932 doctrine that, in an emergency, the federal government must see to it that nobody starves in this country is out the window. We now have the much broader Hopkins' doctrine, that this country owes every person not merely an equal chance to work but an actual guarantee of a job and that, if the economic system does not provide it, the federal government will.

That is established New Deal doctrine. It creates a vested interest whenever and wherever unemployment exists and as long as it exists. It seems to have been accepted that we must now get ready to take care of some amount of unemployment forever—and, what is still more astonishing, that this is not a duty of the local communities, not a duty of the states, but solely of the federal government, regardless of where the unemployment is, of what local conditions caused it, or of anything but the fact that it does exist.

That is vested interest in federal spending No. 1. It is overwhelmingly clever. It automatically ranges behind itself, and vests with an equal interest, not merely the unemployed themselves but the civil authorities of every state, city or county wherever they may be.

For these are charges against federal revenue; but all federal revenue comes from the states. What a " sap " any gov-

ernor or mayor would be to let taxes run out of his locality to the federal government and not get back at least his own locality's just proportion in federal relief of unemployment. If he did, he would be permitting his tax-paying people to support the unemployed in distant states. Also, there would be charged up to the debit of his political administration the additional charge for whatever local taxation was needed in his own locality to take care of its own unfortunates. No local political officer could support that criticism.

Think of the implications of this system. It not only creates a vested interest in federal spending in the unemployed themselves, but it also creates a vested interest in every locality and every local official and government for its share of the federal plunder and, of course, that tends to multiply the expense.

But this system does something much worse. It binds every local government and every locality by the strongest possible bondage of arbitrary patronage to the existing federal administration. The struggle is not to get a new gift but only to get back a fair share of the federal tribute which has been taken away and which, if not so taken, could have been applied as its own taxpayers saw fit.

It binds local politics to national administration in a way that would have been impossible except for this gratuitous and unprecedented assumption by the federal government of a responsibility for local unemployment and local relief. Why, that has no warrant whatever in anything in American constitutional law, traditions or inhibitions. It is one of the most powerful, far-reaching, vicious and subversive departures in our recent history.

In addition to creating a vested interest in federal spending in the unemployed and in every local government in the country, it creates a corollary vested interest in the federal government, in the political domination of states, counties and congressional districts, in the destruction of local self-government everywhere and in the centralization and personalization of government in Washington, D. C.

That, coupled with the surrender by Congress to the executive of the constitutional power of the purse, through lump sum appropriations permitting the executive their local allocation, is one of the most dangerous developments of recent

history. It subjects not only every congressman and senator but every governor and mayor to an almost compelling domination by the national administration in power.

A good deal of the same thing is seen in the evolution of agricultural legislation. We started out to right an early inequity in our system. Tariffs automatically fail to protect the domestic price of export farm crops. The surplus had to be sold abroad at world prices. The best obtainable price for a surplus of any product invariably becomes the price of the crop. The tariff did not protect the farmer on these crops, but it highly protected the domestic price of all the industrial products the farmer had to buy. Therefore, agriculture has always been forced to buy in a protected market and sell its export crops in a free-trade market. It seemed only justice to promise it a benefit equivalent to the tariff benefit to industry or that part of any export crop consumed at home.

There were several ways to apply this principle. The 1932 election made that a vested interest—not necessarily in federal spending but in the price the consumer must pay.

But this vested interest is not only being shifted to federal spending. It is being tremendously expanded beyond its original justification. It now applies not merely to export crops but to all principal farm products. It is no longer merely a benefit equivalent to the tariff, but a more or less binding guarantee of a fixed relative farm income from all crops. It has been worked out to provide not merely a benefit differential in domestic price but a surrender to the Secretary of Agriculture of the farmer's right to plan and execute his croppage, move his product to market at will, or store or ship it at his pleasure.

Like the new federal unemployment dogma, it not only gives the farmer a tremendous vested interest in federal revenue, it gives the federal government a greater vested interest in the farmers' private economic freedom and, more sinister and subversive still, in the internal political affairs of every farm state. It practically delivers them bound hand and foot to political centralization—and perhaps perpetuation—in Washington.

Why? Because this so-called farm democracy is managed, and this tremendous federal subsidy is allocated and distributed by thousands of interested committees guided by hundreds of political county agents of the Department of Agriculture.

That vast organization and political pie-counter is represented in every farm township and is potentially the most powerful agency for patronage and politics centered on Washington executive and political control that was ever erected in this or any other country.

These two massive examples of vested interests in federal spending in exchange for federal vested interest in local political control and government are only typical of an entirely new political and economic philosophy.

The federal government moves into the Tennessee Valley to make it over by the expenditure of hundreds of millions of dollars in dams and hydroelectric installation in return for a vested interest of the federal government in the control of the internal economic and political affairs of at least four states, through a kind of economic province, responsive to executive control and called a T. V. A.

But the Tennessee is not the only great river system in the United States. If that great basin is accorded, as of right, a steam-shovel dip into federal funds and revenue to recondition the whole countryside, then, under the equitable principle of equality, we have created a vested interest in all the other great river systems. Exactly that is alleged. We are to have six other great economic provinces in some of which there are no river systems capable of development for hydroelectric power or navigation at all.

That makes no difference. If the Tennessee Valley has such a right to federal treasure, they also have a right to similar spending to offset this generosity to their neighbors. The St. Lawrence, the Columbia, the Mississippi, Missouri, Colorado, Arkansas and the Southeast outside of T. V. A.—all have a vested interest in federal spending, whether they need it or not, and incidentally must concede a similar tribute to federal concentration of political power.

These are only three outstanding instances of new vested interests lately and precipitately created by New Deal precedent and acknowledgment of federal obligation and all accompanied by a vast increase in federal political centralization and power. We also have vested interests of youths in C. C. C. and the National Youth Administration—of age and unemployment in Social Security. We have vested interests of people un-

thriftily located geographically in Rural Resettlement, and of people poorly housed in Federal Housing. Puppeteers, mummers, adagio dancers and piccolo players have a vested interest in federal theatres. About the only class that has no vested interest in federal spending is the taxpayers. The whole thing has been so swiftly and so cleverly done that the most heavily burdened of them—the millions of workers earning less than $2000 a year—have been led to approve and applaud this tremendous and growing burden on their backs—this gutting of their pocketbooks up to 20 per cent of their pitiful incomes—this appalling mortgage on their futures—they have been fooled into regarding it as something in their interest.

What are all these vested interests in federal spending going to do to us before we get through? The total federal spending from 1932 to 1937 is just under 42 billions or 7 billions average. It now is running at a rate of 24 millions a day—or more than 8 billions a year. Of the total amount of 42 billions, 16 billions is accounted as for "relief and recovery"; but that classification is almost meaningless. The accounts have been so qualified, scrambled and arbitrarily divided that about all that can be said is that whereas, before we created these new vested interests, government was costing 3.5 to 4 billions, it now costs 8 to 8.5 billions. In other words, vested interests in federal spending are taking somewhere around 5 billions a year.

What are the prospects of reduction? In my opinion, nil. Nearly all the talk of a balanced budget has centered on increased revenue due to increased business—not on decreased spending. Total spending has steadily increased, is still increasing, and many vested interests have not yet been served.

With a grave business recession there can be no increased revenue. Revenue will decrease. With probably greatly increased unemployment, and all these vested interests not yet provided for, talk of a balanced budget is as vain as hope for decreased spending.

There is an unarguable practical reason why there is no relief in sight. The political power of this administration now rests almost wholly on the creation of these vested interests in spending. The midwest farmers are congenital Republicans. They are New Dealers with their tongues in their cheeks—as long as the checks arrive and not one moment longer. The

same is true of many of the unemployed and of many benefited regions.

When, if ever, those interests in spending are divested the New Deal is done. Therefore, they will not divest as long as New Dealers control government, taxation and spending.

I am not saying that many of these interests did not have to vest. I am for some of these measures and bitterly against others; but, as I understand it, I was not asked here to discuss private opinions on the merits of federal policy. I am here solely to discuss the condition as it is. It is just about the biggest and most dangerous subject in our national life, and I have not skimmed its surface—but that is all I can skim in twenty minutes.

Remarks by the Chairman

President Mitchell: The next subject on the program is one that may add to the gloom. Professor Hansen found himself under the necessity of pointing out some sad consequences of reducing expenditures. General Johnson has pointed out that, greatly as these expenditures have grown, there is little chance of reducing them. If they are not reduced, it would seemingly be necessary to increase taxes, and the horrid results that would follow from this alternative are now to be explored by a high authority.

Mr. May is one of the most distinguished accountants in this country and Great Britain, a counselor of the United States treasury during the difficult years of war financing, a man whose contributions to the literature of his own profession and of economics have been so important that his occasional papers have been republished in book form, and one who lightens the often arid literature of economics with felicitous touches for which all readers are deeply grateful. I have the pleasure of introducing Mr. George O. May.

THE CONSEQUENCES OF INCREASING TAXES

GEORGE O. MAY
Senior Partner of Price, Waterhouse & Co.

THE effects of increased taxation can hardly be discussed satisfactorily without reference to the method of taxation employed. I propose, therefore, to consider mainly the increases put into force in the last two years, some of the results of which, I think, we can already clearly perceive.

Two important aspects of the question we are considering today are: the deflationary influences of taxation, and its effect on industry and enterprise. Since our time is limited, I would merely say upon the first point that, in my judgment, any adverse deflationary (or perhaps I should say "un-inflationary") influence of financing wholly through taxation instead of partly through borrowing would, at the present stage of our affairs, be small compared with the benefit from the increase in confidence which an actual balancing of the budget would be likely to produce.

Upon the vital question of the effect of taxation on saving and enterprise it is necessary to say a little more; but before doing so, I should like to touch briefly upon other consequences of our high taxation, some of which, if less important, are perhaps also less generally apprehended.

One effect is the uncertainty and instability of the revenue. This is strikingly illustrated by the difference between the estimate made in January and that made in October of the yield of the tax system for the year now current. The percentage of difference between the two estimates of the yield of the same taxes for the same year is as large as the percentage of difference between the highest and the lowest aggregate yield of the British tax system over a period of thirteen years, and there seems to be reason, now, to doubt whether even the October estimate will be realized.

The notable difference between our system of income taxation and that of Great Britain is that Great Britain has refrained from raising maximum rates of tax to the levels which

we have put into force—not (as the report of the Colwyn Committee makes clear) out of consideration for the taxpayers directly affected, but in the interest of the people at large. On the other hand, they have made the tax on moderate incomes much steeper than we have. I believe a readjustment of our rates along similar lines would be advantageous, and I further believe that those, like myself, who would feel the immediate burden of such a revision, would be more than compensated by the indirect benefits that would flow from a sounder and more stable tax policy.

Such a readjustment would find ample support in the writings of American economists. From the War days, when the income tax first became a serious element in our fiscal policy, I recall the insistence of Dr. T. S. Adams on the desirability of raising the tax rates in the lower brackets to much higher levels than even in that emergency the Congress was prepared to consider. Among other advantages of such a course he believed that it would make easier a downward readjustment all along the line when the emergency had passed. It was perhaps the chief merit of the Mellon tax plan that it restored a more reasonable relation between the rates of taxation in the higher and those in the lower brackets, and thus afforded a better basis for a general increase in time of need than previously existed. However, when the new emergency came the error of the earlier days was repeated, and once again the effort was made to raise the necessary revenue by taxation that would fall, at least in the first instance, on the very rich.

Other inevitable consequences of our very high rates of taxation on income are a growing complexity of the law, growing costs of administration, and a constant tendency of the tax administration to attempt to prevent evasion by the enactment of special provisions which, even if effective for the purpose designed, impose unjust and unreasonable burdens on taxpayers who have been guilty of no attempt to evade taxes. Experience has already shown that the provisions of the 1937 "loophole" law have imposed heavy burdens on taxpayers whom the treasury, probably, and Congress, certainly, never contemplated as being subject to the new provisions.

The commonly accepted justification for a highly progressive income tax is the principle of ability to pay, or, as it is

sometimes called, the principle of relative equality of sacrifice. Up to a certain point, the amount of income may properly be used as a rough measure of ability to pay; but when taxes are not merely five per cent or ten per cent, but fifty per cent or seventy-five per cent, the difference in the ability to pay represented by different types of income must be recognized or gross tax injustice will result.

The truth of this statement is sufficiently illustrated by consideration of a number of forms of income, all of which are treated on a substantially identical basis under our law—such as the income from a holding of gilt-edge bonds maturing a hundred years hence; the salary or professional income of an individual who has reached and can expect to maintain for only a short span of years his period of maximum earning capacity; the evanescent income of the artist who happens for the moment to be the popular favorite of a fickle public; or the income derived within a short period from the completion of work or studies which have occupied a period of many years.

In the congressional hearings held this spring as a result of the failure of the revenue to reach the expected level, the treasury called attention to the discrimination which results from the existence of community property laws in some states and not in others, and from the special relief provisions applicable to the taxation of those engaged in exploiting the natural resources of the country. The list could be extended indefinitely. There is, for instance, the so-called gain which reflects nothing more than a fall in the purchasing power of money.

The attempt to secure a closer approach to tax justice necessarily results in a more complex law, and this complexity further adds to the cost of administration. It is, I think, an error to measure the cost of administration of the income taxes by the amount of expense incurred by the government itself in the collection thereof, especially under a system which imposes a very large part of the work of determining the tax upon the taxpayer or upon experts employed by him. The real cost is surely the difference between the total outlay by the taxpayer, including both the tax and the expense incidental thereto, and the net amount available to the government after deducting its own expense of collection. Thus measured, the administrative

costs of the tax are far from being the inconsiderable figure sometimes put forward.

Along with increased income taxes we have enacted laws imposing very high maximum rates of tax on transfers by gift or upon death, and I should like to draw particular attention to two consequences which are not, I think, adequately recognized. Both grow out of the difficulty of determining the value of a business enterprise. As I have pointed out on other occasions, the limits of legitimate difference of opinion in regard to the value of a privately owned business may be so great that in some cases taxation on the basis of the higher limit of value would result in a tax substantially in excess of the lower limit, and, therefore, in complete confiscation. May I cite an illustration I used before the Senate Finance Committee? A Commissioner of Internal Revenue valued a holding of stock originally at $47 a share, and subsequently reduced it to $12 a share, and the Board of Tax Appeals fixed it at $7 a share.

This has two results: first, that in the circumstances I have outlined, taxation becomes, in practice, taxation at the discretion of the taxing authority, subject only to such limitations as may be imposed on it by the taxpayer's right of resort to the expensive and unsatisfactory process of determination of value by courts necessarily ill-equipped for the purpose; second, the hazards of leaving a private enterprise as a part of one's estate are so great as to create a strong incentive to the elimination of this type of organization (which has in the past been regarded as the backbone of our American system) through conversion into publicly owned companies in which management is divorced from beneficial ownership. The private owner becomes a salaried employee. This tendency has developed in England; and the London *Economist* of October 9, 1937, contains an interesting discussion of some of the consequences.

I now turn to the vital question of the effect on saving and enterprise of the present high taxes on income, including the undistributed profits tax. That taxes on income, if raised to excessive levels, profoundly discourage saving and enterprise is, I take it, agreed by economists of almost every school of thought. I would quote only a single passage from an English

socialist source—the report of the New Fabian Research Bureau on *Taxation under Capitalism.* After discussing the doctrine that " all our troubles arise from an excess of saving and of fixed capital ", the report says:

> The results of a failure to invest afresh, or of a failure to keep old capital efficient and up-to-date, are not easy to exaggerate. To anyone not obsessed by the entirely erroneous doctrine we have just discussed, it is clear that the ability to offer more employment and higher wages depends upon the existence of factories which are up-to-date and properly equipped, and this in turn depends upon the adequacy of the supply of new savings, and the complete reinvestment of monies set aside for depreciation. Equally, the exploitation of our increasing power over nature, and provision of employment for those set free by the increasing mechanisation of the older industries, depend alike on the investment of savings at an adequate rate in the development of those new industries which, in a progressive society, are always springing up.

High income and estate taxes have been in force in England longer than here, and their effect on saving and enterprise can be observed there more clearly. Apparently they have affected both the amount of savings and the form of investment sought by the saving that is made. Colin Clark reaches the conclusion that the sources of new capital there are now practically reduced to undivided corporate profits, institutional savings (by building associations, insurance companies, etc.) and governmentally provided capital. The change from saving by the well-to-do to institutional saving has naturally resulted in an increased demand for prior charge securities in established companies and a reduced supply of capital for investment in equities and new undertakings. From the standpoint of the people as a whole, this change is regrettable.

How high taxes may be put without exerting a restrictive effect that is seriously prejudicial to enterprise is a question on which disagreement no doubt exists. I am among those who would put the limit higher than many others; but I think no one can study the English evidence, including that presented before the Colwyn Committee or the report of that Committee, without being convinced that we have reached and passed this danger point in our taxation.

In its approach toward a more nearly balanced budget, the administration in its original estimates anticipated in the year

now current a yield of approximately three billion, four hundred million dollars from income taxes. This large estimate was predicated on the expectation that the new law would force within the ambit of the personal income tax a large, probably an unwise, distribution of corporate profits; but it also rested fundamentally on the expectation of larger profits. If that expectation was to be realized, and the administration's other recently reiterated objectives of increased wages, shorter hours and lower prices were also to be attained, the result could only be achieved by a large increase in production, which, if we take any but the shortest of views, must imply a large investment of capital in new enterprise. I believe that today enterprise is greatly discouraged by the existing level of income taxation, and by a widespread feeling that this taxation is neither just nor justly administered.

In the last paper on taxation which he wrote, the late Dr. T. S. Adams, after an allusion to Adam Smith's four canons of taxation, said: "Taxes should not only be equal, certain, economical, and convenient, but they should be temperate. Personally, I should assign more practical importance to certainty and temperance than to equality." Without attempting to decide the question he raised, we can at least agree that the higher taxes are, the more important it is that they should be certain and equitable. Doubtless in a great emergency even these qualities may have to be sacrificed to necessity and immediate productivity. But, if our present system of income taxes, which are extremely high, manifestly unjust in many respects in operation, and uncertain in administration, was justifiable on the ground of absolute need at an earlier stage of the depression, surely the time has come when the defects should be remedied.

That the income tax law (which includes the undistributed profits tax) is unjust in concept can scarcely be denied, in view of the provisions which tax capital gains while making only nominal allowances for capital losses, and which subject to the regular income taxes and the undistributed profits tax the gains of profitable years without regard to the losses of the unprofitable years.

Few, I think, realize with what harshness the present taxes fall on corporations whose operating results fluctuate at all

widely. I was looking, a few days ago, at the figures of a company formed in 1927 to combine two comparatively small businesses in the capital goods industry. In the ten years that have elapsed, it had had six profitable years, during which its income amounted to a little more than three million dollars, and four unprofitable years, in which its losses had totaled just about two million dollars. I asked one of my tax associates how the company would have fared if the present taxes had been in force for the ten years and if it had reserved enough profits in the good years to meet the losses of the bad, and had paid out all the remaining profits, after taxes, by equal annual dividends over the decade. His answer, when he worked it out, was that of the net profits of, roughly, $1,050,000, over $450,000 would have gone in income tax and no less than $525,000 in undistributed profits tax, leaving less than $75,000 or $7,500 a year, available for distribution to stockholders. This is neither an exceptional nor an extreme case; and not even that hardy optimist, the American business man, can be expected to enter a game in which the odds are so heavily against him.

It should be observed that these adverse effects fall most heavily on industries which require large investments in capital equipment.

If I may resort to analogy, it seems to me that the administration originally contemplated that the race against the forces of depression would be a relay race, in which government spending would carry the baton for the first lap and private industry for the second. In relay racing, smoothness in the transfer of the baton is of vital importance. Unfortunately, as it seems to me, the administration at the critical moment allowed its attention to be distracted to other objectives, and in the enactment of the undistributed profits tax law took a step which threw industry out of stride and caused confusion, in which the baton was dropped, with the result that the forces of depression regained much of the advantage which had been wrested from them. The question, now, is whether the administration will adhere to its original plan and take steps to aid industry to make up the ground that has been lost, or whether it will attempt to carry the baton through the second lap itself. I hope it will choose the first of these alternatives.

This seems to me to involve, among other things, the repeal or substantial revision of the undistributed profits tax law. There has never seemed to me to be any reason to regard that law as a valuable producer of revenue, nor has it seemed to me to be a suitable instrument for producing such redistribution of the national income as may be deemed desirable. I am convinced, however, that it has discouraged, is discouraging, and will continue to discourage employment and the production of income. It seems to me to have no proper place in the fiscal scheme of an administration whose first concern is to add to the well-being of the less prosperous of our people, for their position can only be improved materially and permanently through increased employment and increased production.

Remarks by the Chairman

President Mitchell: The fourth paper on our program, " Will Revenues Be Adequate to Balance the Present Scale of Expenditures and to Keep It Balanced? ", will be presented by Professor Roy Blough, Professor of Economics at the University of Cincinnati.

Professor Blough has been a statistician with the Wisconsin Tax Commission; more recently he has been one of the advisers of the federal treasury. Through long professional occupation with problems of public finance, he is admirably equipped to discuss this problem which involves in a sense the summing up of the two sides of the federal budget that we have already heard discussed, expenditures and taxes. Professor Blough!

WILL REVENUES BE ADEQUATE TO BALANCE THE PRESENT SCALE OF EXPENDITURES AND TO KEEP IT BALANCED?

ROY BLOUGH

Associate Professor of Economics, Graduate School of Public Administration, University of Cincinnati

MAY I preface my remarks by saying that no work that I have done with the federal treasury has been concerned with the problem that I am about to discuss. To venture a definite forecast in answer to the question put by the assigned subject would be indeed foolhardy, especially in view of the frequently large errors in the estimates of treasury experts. Forecasting is based on statistical regularity. The operations of the present economic order, and especially of the tax system in the economic order, are subject to wide variations from any regular pattern and are increasingly controlled by the unpredictable decisions of a relatively few persons within and outside of government. Less hazardous than forecasting is the attempt to analyze some of the factors that affect federal revenues and the probable operations of those factors under different sets of reasonable assumptions. Such is the task undertaken here.

The wording of the subject involves three questions. (1) What is meant by " adequate to balance . . . and to keep . . . balanced "? (2) What is the " present scale of expenditures "? (3) What will the " revenues " be?

The first question is one of definition. The term " adequate to balance . . . and to keep . . . balanced " cannot mean " balance only occasionally ". It might mean " balance every year ". If this is the intended meaning, one may say with almost perfect safety that the revenues will not keep the present scale of expenditures balanced unless there are not going to be any more major depressions. However, the term probably refers rather to balancing over a period of years, more particularly over a business cycle. The question then is, will revenues on the average be equal to the present scale of expenditures?

The second question—what is the " present scale of expenditures "?—necessitates the definition of " present " and of " scale of expenditures ". Does the word " present " mean the estimates for fiscal 1938 in the President's budget statement of October 18 or the actual expenditures recorded in fiscal 1937 or an average of expenditures for the past few years? The estimates for fiscal 1938, which are substantially less than expenditures in fiscal 1937, can scarcely be accepted at the present moment as the present scale, since they may or may not be realized. Average expenditures are a safer basis. There is little difference in amount between a two-year average of expenditures for 1937 and 1938, and a three-year average for 1936, 1937 and 1938. The three-year average of 1936, 1937 and estimated 1938 is accepted here as the most usable meaning of the word " present ", in the absence of a more satisfactory basis.

Several questions arise in defining " scale of expenditures ". The first of these is whether the amount appropriated for statutory debt retirement or the amount actually paid should be included as part of the scale of expenditures. Neither item is included here chiefly because, by omitting debt retirement, any surplus or deficiency of revenue has a more clear-cut meaning. Two other considerations support this position. One is that inclusion of statutory debt retirement sets up a rate of payment —approximately 2.5 per cent a year—which may be greater or less than is most desirable. The other is that, beginning as early as 1936, part of the appropriation for statutory debt retirement was not actually applied to that purpose. In 1937 only $104,000,000 of an appropriation of $572,000,000 was so applied, while the estimated debt retirement for fiscal 1938 is $200,000,000. The appropriation is meaningless when it is not followed.[1]

A second question to be decided in defining the scale of expenditure is whether federal loans to individuals, organizations or governmental units should be included. In fiscal 1937 repayments of such loans exceeded new loans by $243,000,000,

[1] Expenditure and tax figures for 1937 and estimates for 1938 presented in this paper are from President Roosevelt's budget statement of October 18, 1937, and from the annual budgets; figures for preceding fiscal years are from the reports of the Secretary of the Treasury and from the annual budgets.

while in 1938, loans are expected to exceed repayments by \$140,000,000. Since the disbursements are loans rather than governmental cost payments, and the amounts of loans and repayments may be expected to vary greatly from year to year, neither loans nor collections are included here. Greater accuracy would be achieved by counting as expenditures an annual charge for uncollectible loans made, but this has not been attempted here.

An amount equal to "miscellaneous receipts" is also deducted from the expenditures in order to eliminate from the scale of expenditures those that are financed from other sources than taxes or loans. The amount of such receipts estimated for fiscal 1938 is \$210,000,000.

A further problem of deduction grows out of the fact that payroll taxes under Title VIII of the Social Security Act and the taxes on carriers and their employees are being invested in the old-age reserve account and the railroad retirement account respectively. The most desirable method of handling these items appears to be to treat them, in effect although not in law, as trust funds, eliminating both taxes and investments, as well as benefit payments, in arriving at the present scale of expenditures financed from general taxes.[2] The elimination is of little significance except that the scale of expenditures would otherwise have to be changed year by year as the yield of the taxes increased. The Social Security Act does not require tax collections to be invested in the old-age reserve account but any other course would be essentially dishonest, since the taxes are publicly proclaimed as being for old-age insurance and are of a type not suited for financing general governmental functions. The federal share of the payroll tax under Title IX of the Social Security Act, which tax was imposed to encourage adoption of unemployment compensation systems, is not deducted, since no trust fund is established for its investment.

In fiscal 1938 the estimated investment in the old-age reserve account is \$425,000,000 and in the railroad retirement account \$138,000,000, a total of \$563,000,000.

[2] The hope that they may remain inviolate is rudely disturbed by recent proposals to use the old-age reserve account as a guarantee fund or otherwise in stimulating business.

Other factors deserve consideration although neither deduction nor addition has been made on their account. The first concerns interest paid, which is estimated at $925,000,000 for fiscal 1938. In 1936 the average computed rate of interest was 2.6 per cent while in 1929 it was 3.9 per cent or one half higher. An increase in interest rates from current low levels might substantially increase interest charges on approximately one half of the debt since it matures in the next few years.

The second problem is raised by undertakings of the federal government that will increase its expenditures from year to year. For example, the federal government has offered to match state payments for aid to the aged, aid to the blind, and aid to dependent children. The grants to states for these purposes totaled $144,000,000 in fiscal 1937 [3] and will almost certainly increase as more states adopt approved programs and as standards of payment in low level states increase. Somewhat similar are the congressional authorizations for various purposes, such as construction of public works, which authorizations have not yet resulted in appropriations but will so result in the normal course of events.

Still another factor concerns the fact that expenditures in dollars would fluctuate if the present policy of expenditures were kept stable, since recovery and relief needs as well as other demands run in cycles. A similar problem is met in changes in the price level. Since changes in the national income, discussed below, might arise from changes in the price level, there may be some question whether it is logical in this discussion to hold to a present level of dollar expenditures rather than a fluctuating level based on stable expenditure policies. However, the uncertainty of knowing what such policies are, or of applying them when known, probably makes any such computation impracticable.

The position taken here is that since Congress can, if it chooses, hold total expenditures at the present scale in dollars by decreasing some appropriations as others are increased, the factors just discussed should be disregarded in estimating the present scale of expenditures.

[3] Social Security Board, Bureau of Research and Statistics, *Selected Current Statistics*, August 1937, pp. 86-87.

The calculation of estimated net expenditures to be financed by general taxes (or loans if taxes are inadequate) in accordance with the foregoing discussion is as follows for fiscal 1938:

			Millions
Total estimated expenditures			$7,545
Deduct:	Debt retirement	$200	
	Revolving funds	140	
	Miscellaneous receipts	210	
	Payments to old-age reserve account	425	
	Payments to railroad retirement account	138	
Total deductions			1,113
Estimated net expenditures			6,432

A similar computation in which payments on account of the soldiers' bonus were also deducted gives $7,200,000,000 net expenditures for fiscal 1937, while a computation on substantially the same basis for fiscal 1936 gives $6,700,000,000. An average of the three years is very close to $6,750,000,000, and this figure is only a little less than the average of 1937 and 1938. Accordingly, $6,750,000,000 is accepted as the present scale of net federal expenditures that customs and internal revenues must equal if the budget is to be balanced and to stay balanced.

The third question involved in the subject of this paper is, what will the revenues be? Presumably by "revenues" is meant the revenues now provided by law and not revenues that might be raised through measures increasing taxes. The existing revenue system is too well known to require description but it may be recalled that it is a far different system from that existing in 1929 as a result of taxes added or strengthened in 1930, 1932 and every year thereafter.

To bring the definition of revenues in harmony with the expenditures definition some eliminations must be made. Items to be excluded are: repayments to the government of loans made by the R. F. C. and other agencies; social security payroll taxes under Title VIII (for old-age benefits); and receipts from the states for deposit in the unemployment trust fund. With these eliminations the problem may be stated as follows: given a net annual expenditure of $6,750,000,000, will existing revenue laws, operating unchanged during the

next few years, yield an average of that amount, plus, of course, enough to pay interest on any deficits incurred?

After the deductions previously mentioned have been made, the revenue produced by the tax system in 1937 was nearly $4,900,000,000 and is officially estimated to be about $5,800,000,000 in 1938. That the system is extremely productive is evidenced by the fact that if the $5,800,000,000 is realized, the general tax revenues will be the highest in federal history, the previous record being $5,700,000,000 in 1920. Including the social security and railroad retirement taxes the yield will, of course, be substantially more than that record. The expected $5,800,000,000 from general taxes is nearly twice as much as the net federal expenditures of 1930. Yet, despite its expected record volume the 1938 revenue will be nearly $1,000,000,000 less than the average $6,750,000,000 scale of net expenditures (from taxes and loans) for the past three years.

The hope of balancing the present scale of expenditures rests, therefore, on the possibility that improved business conditions will increase the revenue by about $1,000,000,000. That this may occur is by no means inconceivable. The federal revenue system is very sensitive to business fluctuations. The variations in its revenues are much greater than those of the national income. Although there are some very stable revenue sources, income, estate and gift taxes, which are notably variable in yield, are the major elements in the federal system; they are expected to produce 55 per cent of the $5,800,000,000 total for 1938.

The variations in the probable yields of the tax system are indicated in tax estimates appearing in the Twentieth Century Fund publication, *Facing the Tax Problem.*[4] For a year of deep depression such as 1933 it is there estimated that the system will produce not more than $3,100,000,000; for a year of moderate prosperity such as 1924 about $4,900,000,000; and for a year of great prosperity such as 1928 about $8,200,000,000.

The estimate of $8,200,000,000 for a year such as 1928 must be used with some degree of caution since it includes $1,300,000,000 of tax on capital gains. The capital gains of 1928

[4] Carl Shoup, Roy Blough, and Mabel Newcomer, *Facing the Tax Problem* (New York, 1937), chap. 8.

may recur rarely, if ever. Furthermore, it seems highly unlikely that if the tax rates now imposed had been in effect in 1928 the volume of realized capital gains would have been as large as it was. Finally, any continued period of high income would not show continued high capital gains, since prices of property and stocks would become adjusted to the new levels. A later publication of the Twentieth Century Fund accepts $7,000,000,000 to $7,500,000,000 as the probable yield of the present tax system at a national income level of 1928.[5]

Thus, it appears that in a period of high incomes, such as 1928, the revenue system would yield a surplus of approximately $750,000,000 over the present scale of net expenditures. At the 1924 level of business the deficit would be nearly $2,000,000,000, and at the 1933 level over $3,500,000,000, despite the fact that even for that year the estimated revenues would have more than balanced the net expenditures of the predepression years.

The question may be asked, at what level of national income will the revenue system balance the present scale of expenditures? This question cannot be answered with any satisfactory degree of accuracy because the yield of the revenue system is affected by many factors besides the volume of the national income. The distribution of that income is of great importance because of progressive income tax rates. The extent to which income is earned through corporations is significant since special taxes are imposed on them. The rates of interest used in capitalizing future income into present capital values are important, for estate and gift taxes are applied to these values. The expenditure of the income is important since some articles, notably liquor, tobacco, automobiles and imported goods, contribute largely to federal taxes while most other articles are not taxed. Only if the patterns of distribution, expenditure, etc. are the same at all times when national income is at any specific level—a situation that probably does not exist—can satisfactory calculations of tax yields at different income levels be made on the basis of past years. Another problem is choosing between national income produced and national income paid out, since the ratios between them vary.

[5] P. W. Stewart, R. S. Tucker, and Carolyn Stetson, *The National Debt and Government Credit* (New York, 1937), p. 145.

Part of the tax falls on producers and part on income recipients. Figures of income produced are used here.[6]

Only by working from figures for the bases of the different taxes can satisfactory estimates be made. However, if it be assumed that future income distribution and other patterns will be the same as those of the past, a rough interpolation of tax yield figures can be made on the basis of national income. From estimates previously mentioned, and examination of other data, it is estimated that when the national income is approximately $75,000,000,000 the present tax system will yield $6,750,000,000. The national income produced for the calendar year 1936 is estimated by the Department of Commerce at $63,800,000,000 while the tentative estimate for 1936 is $70,000,000,000. The income for 1928 was approximately $80,000,000,000. Thus, if the accepted estimates are correct—and their tentative and approximate nature cannot be too strongly emphasized—the revenues will balance the $6,750,000,000 expenditures, in case national income rises another $5,000,000,000, or to halfway between the 1937 and the 1928 levels.

It was pointed out earlier that to balance and to keep balanced does not mean to balance occasionally. What probability is there that the average national income for the next five or ten years will equal or exceed $75,000,000,000? This question is highly debatable and to answer it would be foolhardy. The experience of the past fifteen years, however, is at least interesting. The average national income for the fifteen years, 1923 to 1937 inclusive, was about $65,000,000,000. The first seven years were years of high income with an average of slightly under $77,000,000,000. The average for the last eight years was $55,000,000,000. If the next few years are like 1923 to 1929 the revenue system should at least balance the $6,750,000,000 expenditure level. If the next few years are like the average of 1923 to 1937, revenues will probably be deficient by more than $1,000,000,000 annually. If the next few years are like the average of 1930 to 1937, revenues will probably be deficient by substantially more than $2,000,000,000

[6] Income calculations are based on Simon Kuznets, *National Income, 1919-1935*, National Bureau of Economic Research, Bulletin 66, September 27, 1937, p. 2, and on Department of Commerce estimates for 1936 and 1937.

annually. Only if the next few years are better than the average of 1923 to 1929 is there likely to be much surplus, above the $6,750,000,000 scale, to apply toward debt retirement.

In the previous discussion the point of view accepted has been that investments in reserve accounts, such as the civil service retirement and disability fund, and the old-age and railroad retirement reserve accounts, are as much a part of expenditure as are cost payments. Investments in the old-age and railroad retirement reserve accounts are financed by special payroll taxes and have been excluded along with those taxes as trust funds in order to avoid a varying figure for the present scale of expenditures. Some writers have suggested that economically the investments in the reserve accounts are not true expenditures. If this point of view be accepted the budget is not far from balanced economically at the present time. If the social security and railroad retirement payroll taxes are included in revenue the estimated tax revenues for fiscal 1938 amount to $6,400,000,000,[7] or almost exactly the estimated net expenditures for the year.[8] As the yield of social security payroll taxes under the existing act will increase rapidly, due to increasing rates, their inclusion in the total revenue should bring it to the $6,750,000,000 level in the near future at the present national income level.

Any budget balance achieved by counting the payroll taxes and not counting investments in the old-age reserve account, however, can be only temporary since benefit payments would have to be counted as expenditures and would increase rapidly within a few years, thus raising the scale of expenditures increasingly above the $6,750,000,000 level. The maximum excess of estimated taxes over estimated benefits is about $1,300,000,000 [9] or somewhat over the amount needed in addi-

[7] Relatively minor adjustments need to be made in expenditures for disbursements from the railroad retirement account, and net investment in the civil service retirement and disability fund, but the effect of these is unimportant.

[8] The effects of receipts from states for investment in the Unemployment Trust Fund are not considered to be in the same class as the payroll taxes for old-age benefits, since the excess of receipts over withdrawals will rapidly decrease and may be replaced by an excess of withdrawals especially in some years.

[9] Paul Douglas, *Social Security in the United States* (New York, 1936), p. 167.

tion to estimated 1938 general tax revenues to balance a $6,-750,000,000 scale of expenditure. After that point is reached benefits would increase and eventually exceed payroll taxes.

One factor that has not been considered thus far in this discussion is the possible effect of the federal taxes themselves on revenue yields. Can the federal government expect to continue to collect the present or a larger volume of revenue, or are the weight of taxes and the tax structure actually destroying the tax yields for the future?

In one sense the undistributed profits tax has this effect since it tends to result in collection in the present of personal income taxes that otherwise would be collected in future years. This results from pressure on corporations to pay dividends in the year in which earned instead of accumulating earnings and distributing them in later years.

The criticisms, however, go much beyond this. Many taxes have been condemned on the ground that they destroy industry. Just now the principal criticisms are brought against the capital gains, undistributed profits, and even the payroll taxes. On the other hand is heard the contention that the present level of national income has been reached because of a large federal spending program, financed by borrowing, and that with the end of the federal borrowing from the public the national income will sink back again to lower levels. These hypotheses and criticisms, although immensely important, are difficult to appraise, and little convincing quantitative evidence either proving or disproving them appears to have been developed. Certainly they contain elements of possible danger to the national economy, but certainly also the current business recession with its numerous and complicated possible causes is not convincing evidence that the taxes are resulting in a decrease in the taxable base. In any case, for the present purpose, the effects of the taxes, whatever they may be, would be reflected in the amount of national income and need not disturb the previous estimates, although they affect the possibilities of attaining and maintaining a sufficiently large national income to achieve a balance.

In a somewhat different category is the effect of the social security payroll taxes on general tax yields. The payroll taxes

will logically reduce the amount yielded by the other taxes, but the amount of the effect is probably not calculable.

Returning to the question put by the subject: " Will revenues be adequate to balance the present scale of expenditures and to keep it balanced? ", it may be said in summary that if the estimates made above are reasonably accurate—and their frailties must be emphasized—the next few years will need to be years of national income substantially above that of 1937 and similar to the average of the prosperous years from 1923 to 1929, if the revenues are to balance and to keep balanced net expenditures at a $6,750,000,000 level. On the probability of that occurring no opinion is expressed.

Remarks by the Chairman

President Mitchell: The discussion of the four interesting papers to which we have listened will be opened under the ten-minute rule, by Dr. James Harvey Rogers, Professor of Political Economy in Yale University.

DISCUSSION: THE FUTURE OF THE FEDERAL BUDGET

JAMES HARVEY ROGERS
Sterling Professor of Political Economy, Yale University

WHEN I was asked to speak at this session of the Academy's annual meeting and to tell this group of budget experts what was the matter with each of their papers, I protested vigorously. Certainly I am not in a position to talk primarily about budgets. However, I agreed to come this afternoon on the condition that I might say something on the general subject of budgets in the present situation, and particularly on "Government Spending and Inflation".

Inflation in the United States may be regarded as composed of two distinct parts which are frequently confused:

(1) The increase in the reserve of our banks, upon which all our credit structure rests.

(2) The utilization of *excess* reserves for inflationary purposes.

The first part represents *potential* inflation only; the second represents *actual* inflation. With this division of the subject in mind, and with emphasis on the *actual* inflationary influence, government spending may be divided into three distinct categories: (a) pure inflationary spending; (b) non-inflationary spending; and (c) deflationary spending—that is, deflationary on net balance, as I shall attempt to describe below. These three categories of government spending it will be my purpose to describe as carefully as I can.

Pure inflationary spending is perhaps best exemplified by the activities of the W. P. A. Through its operations, government funds were turned over to ready spenders who otherwise would have had nothing to spend. Moreover, a large portion of the funds thus handed to ready spenders was raised by purely inflationary financial devices. Let me be explicit. These new funds, at least in major part, were borrowed from our banks through the sale to them of government securities. Thus the investments of the banks were increased and deposits

expanded by an almost equal amount. These new deposits in turn were used in paying the relief workers who thus came into funds which they used speedily in purchasing consumers' goods. Thus, literally out of thin air, were created new funds; these new funds were turned over to ready spenders; and these ready spenders spent them. This is what I call pure inflation. Note carefully, that these new funds thus raised and handled did not —as in the case of business spending—give rise to any additional production of goods or services; and consequently the resulting increase in spending was for *existing* supplies and the *current production* of goods *unincreased by the placing of the new funds in the hands of spenders.* Hence the effect of such spending is apt to be largely on prices rather than on production.

Non-inflationary government spending is of an entirely different character. The most familiar example is that of a country whose budget is in balance. Currently it is collecting funds, currently it is spending them. If its budget is in balance, it is taking from spenders the same amount that it is turning over to spenders. Consequently no effect on prices, and neither inflation nor deflation, is occasioned by the goverment spending.

I can now describe what I mean by *deflationary government spending.* Certainly no spending is of itself deflationary. However, on balance, government spending, as now, may frequently be deflationary. What I mean is this. While our government is during this fiscal year running a deficit of $695,000,000, its expenditures *on balance* are actually deflationary. The reason is as follows: at the same time that our government is turning over to spenders $695,000,000 more than it is taking in simultaneously in the form of taxes (and of loans by investors), it is actually taking in an even larger sum than this big deficit in the form of payments under our Social Security Act and in certain other minor ways. Moreover, the great bulk of these payments is taken in from very ready spenders. Hence the net deflationary influence is measured by approximately the difference between these social security contributions and the net budget deficit. This difference is now estimated for the fiscal year 1937-38 at approximately $370,000,000.

Some of you will ask however: What about business spending? Is this not much more than enough to make up the small

deficit in government spending? The answer is: It has been—until the past few months. Since last June, however, there has been a rapid falling-off of capital flotations—the chief source of sustained buying of producers' goods—and since March a marked, though less rapid, decline in bank loans and investments. Not only is the deficit in government spending no longer being made up by business spending, but the deficit in one is being aggravated by that in the other.

What then is to be done about it? If I were determining the policy, I should patch up the economic system where it seems to be breaking down. To eliminate the shortage in business spending (there is still no substantial shortage in consumer spending) I should try to rebuild the capital market. To accomplish this, I should operate along three different lines.

1. I should remove all unnecessary expensive and time-consuming restrictions on the flotation of securities. This does not mean that we should return to pre-depression policies and the resulting abuses. Certainly few thoughtful citizens desire that. It is of great importance however that it be made easier, less expensive, and less risky for our investment houses to begin again to operate effectively.

2. I should try to give investors a greater incentive to save and to invest. This could be accomplished by allowing them to keep a larger portion of their capital gains. In my opinion, the consistent saver and investor is one of the most worthy and commendable persons in our society. On his activities depends nothing less than the continued growth of our national wealth and income. I should like to see his importance to the economic system recognized by giving him greater income tax concessions on capital gains than on other income.

3. I should try to give business a greater incentive to expand. One device for accomplishing this would be, at least in depression, to reduce substantially the undistributed earnings taxes on all funds actually used for plant or equipment during the current year. In addition unnecessary restrictions on various types of business resulting from hasty legislation during the past few years could be removed. These and other devices all directed to the end of making it *easier,* less *risky,* and more *profitable,* to *float,* to *own,* and to *issue* new securities would do much to reëstablish our capital market. In my opinion

it is no less than a *calamity* for the United States, the richest country in the world, and the one where savings are most abundant, and industry most productive, to be forced to run along for years without a thoroughly effective capital market through which the savings of its people can be turned quickly and without friction into current economic welfare and into continued growth of national wealth.

Funds coming through the capital market, however, are always slow in producing their effects, and in the present case where it is necessary first to rebuild the capital markets themselves, they are apt to be even slower. Under the circumstances therefore, and temporarily, I should resort again to government spending. This time, however, I should certainly not do it on a W. P. A. basis, but on a P. W. A. basis. The slump started and is developing most rapidly in the capital goods industries. Hence, I should see to it that the impact of the new spending be upon such industries. In other words, what is needed is a temporary public works program; and after our recent experience in this field there is no reason for repeating the errors of the past few years.

A public works program *par excellence* is a big armament program. In its prosecution not only would the greatest purchases be made from the heavy industries which are suffering most in the current slump, but also the resulting output would have the additional advantage of not competing with that of any private business. Furthermore, in the present state of the world, it seems to me that such a program would soon be regarded by peace-loving people as just as constructive as the one already in operation in Great Britain. For the great democracies which, with associated countries, continue to control 80 to 85 per cent of the economic system of the world to remain pacifist long enough to make it possible for them to be forced into war by a small group of irresponsible militarists, temporarily in power in countries which control not more than 20 per cent of the world's resources, seems to me an absurd policy. A vigorous and speedy rearmament program on the part of the United States would in my opinion do more to blast this fantastic situation and assure peace than anything else that could be added to the program already under way in Great Britain.

REMARKS BY THE CHAIRMAN

PRESIDENT MITCHELL: That completes our formal program. We now have half an hour for discussion from the floor, under the five-minute rule, which I am in duty bound to enforce strictly.[1]

[1] Space limitations make it impossible to print in these PROCEEDINGS the interesting discussion by several members who spoke from the floor under the five-minute rule.—ED.

PART III

EXPENDITURES OF THE FEDERAL GOVERNMENT

INTRODUCTION *

S. PARKER GILBERT, *Presiding*
Of J. P. Morgan & Co.
(Member of the Treasury War Loan Staff, and
Assistant Secretary and Under Secretary of the Treasury, 1918-1923)

A WISE MAN once said that everything sooner or later comes down to a question of finance. This truth has been impressing itself more and more upon us during the past year, as one thing after another comes home to roost. And so we have dedicated this Annual Session of the Academy to a study of the finances of the Federal Government.

In order to clarify discussion we have deliberately chosen to speak in terms of controlling expenditures rather than of " balancing the budget ", which has become such a slogan and is used so blindly that it often confuses thought. Of course, the budget ought to be in balance, income against outgo, with a sufficient margin each year to allow for the sinking fund and other statutory debt retirements. That is the first rule of sound public finance. But the budget of a country like ours cannot be considered in a vacuum apart from the life of the country itself. In a great war, for example, where national existence is at stake, no one questions the expenditures necessary for the winning of the war, and the resulting deficit has to be financed. So also, in a great national emergency, as in the last depression, the national credit has to be used for the time being to fill the gaps in private spending and private credit. When the

* Introductory Address of the Presiding Officer at the Third Session of the Fifty-seventh Annual Meeting.

emergency is over, the first and most significant stage of budgetary recovery is the end of deficit financing, when cash income and cash outgo are brought into balance. That stage we now appear to have reached, after seven successive years of deficits.

The national credit, if it is to be kept good for the time when the country most needs it, must not be abused. It is the most precious of all national resources, and the best protection against national emergencies. But it is sensitive and can be impaired if, for example, it appears that expenditures are getting out of control or are being made on a scale or for purposes which shock the public conscience. Constant vigilance must, therefore, be maintained to make sure that expenditures are brought back within the available revenues at the earliest possible moment after the emergency has passed.

This was done after the Great War when expenditures were brought down from nearly seven billion dollars in the fiscal year 1919-1920 (which to the Treasury represented the first full year after the peak of war expenditures) to about four billion dollars (including statutory debt retirements) in the fiscal year 1921-1922. Federal expenditures were, in fact, held down to around this level for the next five or six years, due largely to the work done by the Bureau of the Budget under the inspiration of its first Director, General Dawes, and to the effective coöperation of the Executive and the Congress, who actively competed with each other to reduce expenditures to the lowest possible level.

Unfortunately the same results were not accomplished after the depression, and it is this situation which has been giving rise to concern. Leaving out of account statutory debt retirements and the large special payments for the soldiers' bonus, federal expenditures in the last two fiscal years, 1936 and 1937, averaged about seven billion dollars a year, with 1937 expenditures rising to a total of nearly seven and one half billions. In other words, expenditures have grown to nearly twice their pre-depression level, and have been showing signs of getting out of control. The net federal debt, including guaranteed debt, has increased from about sixteen billion dollars in 1930 to about thirty-nine billions in 1937. Expenditures which were started to meet emergencies have been fastening themselves

on the country as fixed charges. Vested interests have been created which are growing more and more insatiable in their demands. And the size of the federal establishment itself has passed all records. The " appetite has grown by what it fed on ", and unless checked these constantly mounting expenditures threaten to devour the country's substance.

This fiscal year has seen a reversal of some of the most threatening tendencies, and more progress, I think, is being made than most of us realize. The Secretary of the Treasury has long been exercising the influence of his great office toward bringing federal expenditures under control, and with the support of the President he has been able to check many new demands for expenditure, and to obtain important reductions in other fields. This is no easy task, with habits of spending as deeply ingrained as they are. It is in fact a continuing task of the first magnitude, and the Treasury's determination to bring expenditures under control offers real grounds for encouragement, not only in itself but also because it is matched, I believe, by a growing determination in Congress and still more among the people of the country to put an end to extravagance and reckless expenditure. This determination is growing as the burden of taxation is increasingly felt and it is realized that the Government has nothing to spend except what it gets from the pockets of the people, that all expenditures sooner or later have to be paid out of taxes, and that inflation would represent the cruelest possible form of taxation, imposing its burdens on those least able to bear them in the form of increased costs of living.

The most significant thing thus far this fiscal year is that Treasury cash income and cash outgo are coming substantially into balance, after taking into account the receipts from social security taxes, which, whatever the demerits of the law, do represent cash receipts to the Treasury. This means, if continued, the end of deficit financing, and thus the disappearance of the only real threat of inflation to which the country has been exposed. The fear of inflation, paradoxically enough, is itself deflationary, and if that fear can be eliminated by firm Treasury control of the budget and at least a balance of cash income and outgo, the result will be to provide a new basis of confidence for that revival of private business activities

which is necessary in order to take the place of the artificial stimulation which has been for so many years provided by abnormal Government spending.

For the same reasons, and to avoid deflation, it seems to me time that the Federal Reserve System, and the Treasury itself, should take note of the cessation of deficit financing and relax the series of deliberately deflationary measures which were put into effect in 1936 and early 1937, and which are still operating (though the reason for them has ceased) to deflate not merely the country's banks and business activity but also agricultural prices and general employment. In other words, we want neither inflation nor deflation, both of which are harmful to the welfare of the country and to be avoided.

The Administration, I believe, should also bring to an end at the earliest possible moment the uncertainty as to the value of the dollar, by renouncing the present power to make further changes and confirming the value fixed in January 1934, which, if deficit financing has ceased, should be able to stand the further test of time. This year, for example, the structure of business and prices has been repeatedly disturbed by the continuing uncertainty about the value of the dollar, first from fear that the gold price would be reduced and recently from fear that it might be increased. The resulting fluctuations in commodity prices and in the attitude of businessmen of all kinds toward inventories, purchases, and commitments for new business have been depressing and deflationary, and are responsible in considerable part for the present business recession. The great community of industry and commerce has been badly whipsawed in the face of this fundamental uncertainty, which should be promptly removed, so that they may again be able to plan for the future.

The progress thus far made in balancing the cash budget must not be allowed to obscure the vital importance of more effective control and further curtailment of expenditures. Even now, on the basis of the Treasury's latest estimates, the Federal Government will be spending this fiscal year at the rate of around seven billion dollars. This is far too heavy a burden for the people to bear. It is gradually lowering the general standard of living, and as the Government takes to itself in taxes more and more of the country's annual produc-

tion, less and less, whether they realize it or not, is left for the people as a whole. The first principle, therefore, is that no additional taxation should be levied, and that further progress should be made by curtailing expenditures rather than by new taxes. The opportunities for curtailment have barely been touched. The task which remains can be accomplished, but it requires in the first place constant Executive pressure through the Treasury and the Bureau of the Budget to bring down to reasonable figures the expenditures of the Executive Departments and the spending agencies. It requires a willingness in Washington, and a determination in the states and municipalities, to return to our best traditions of local self-government and local self-reliance. It requires self-denial on the part of those vested interests in spending which have grown so great in recent years. Above all, it requires the active interest and support of the great body of the people for the efforts which the Treasury and the Executive make in the direction of real economy. There are still vastly more taxpayers, direct and indirect, than there are beneficiaries of Government payments; and if the taxpayers will only assert themselves, the Treasury's pressure to reduce expenditures will be immeasurably more effective.

The national credit depends not merely on the control of expenditures, but also on the taxing power and the state of the revenues. Here the outstanding fact is that the country is already too heavily taxed, that present taxes are sapping its vitality and impairing the sources of revenue. Taxes should in fact be reduced. And a wise revision of the laws, which moderated the present extremes and showed regard for the trend of the country's business, would by revitalizing agriculture, industry and employment put the revenues on a much healthier basis and yield at least as good returns. At present it is fair to say that we have probably the worst tax system of any civilized country. This is not the fault so much of any one political party or administration, though it must be admitted that the last five revenue laws, passed one each year for five years, have contributed some of the worst pieces to the crazy quilt.

Our present taxes are oppressive and destructive, and in combination with the complicated and frequently very high

taxes imposed by states and municipalities on the same taxpayers, often come close to the point of confiscation. Instead of aiming to collect fair taxes on the multitudes of transactions and the great volume of business profits which would normally occur in a great country like ours, the tax laws prevent transactions and dry up business profits and business initiative. They have greatly impaired both individual and corporate savings, so that there no longer exists an adequate fund of savings to finance improvements and new enterprise. Frequently, they aim largely to punish, or to accomplish other ulterior objectives, but whatever satisfaction this may give, we are learning that it does not produce revenue.

In addition to being unscientific, our tax system is hypocritical, un-democratic, and un-American. This may be due in part to general indifference and unwillingness to face facts, and to a strange preference for emotional methods of taxation. The result, however, is that we have a tax system which puts impossible burdens on struggling new businesses and new developments, and on the man who has his way to make in the world, thus threatening the chief mainsprings of individual and corporate activity which over our history have accounted so largely for the growth of the country and the great improvement in the general standard of living.

Present taxes actually favor established interests and accumulated wealth. The so-called undistributed profits tax, one of the most wicked taxes ever devised, falls heaviest on small and growing businesses and on those which are struggling and burdened with debt. To the great established business concerns it is relatively more bearable, but it affects them arbitrarily and unevenly, and they too suffer from the general damage to the country's business. The tax produces little or no revenue, it paralyzes the capital goods industries, and it greatly exaggerates extremes of boom and depression. It prevents business of all kinds from building up reserves of economic and financial strength against future emergencies, and forces it under severe penalties to dissipate its resources. And while the Government pursues monopolies through the Trade Commission and the Department of Justice, through this tax it actually promotes monopoly by confirming already established interests and discouraging and perhaps preventing the

growth of competitors. After a little more than a year of operation, the undistributed profits tax has proved itself not merely a complete failure but a destroyer of constructive business and employment. Its immediate repeal is one of the most helpful steps that could be taken.

The individual is affected in much the same way by the present income tax system, federal, state and local. The extremes of the income tax are arbitrary and capricious in their operation from year to year, are so high as to deaden if not destroy individual initiative and enterprise, and they are known to be relatively unproductive. While there exists a full-fledged system of tax-exempt securities which provide a refuge from these taxes for accumulated wealth, no such relief is open for the individual who has to make his way in the world and who must pay taxes to such a point that it is becoming steadily more difficult for him ever to get ahead or to accumulate enough savings to provide for his wife and family after his death.

The taxation of people of relatively small incomes is equally hypocritical and perhaps more burdensome. In fact their taxes are high but many of them are hidden taxes, levied apparently on the principle that it is best for people not to know they are paying them. These taxes fall hardest on those least able to bear them, because they appear largely in higher costs for articles of necessity, and frequently become multiplied several times in the process of manufacture and distribution of goods. And in addition there are the so-called social security contributions, which I think must frankly be regarded as taxes on employment. Under the law as it stands, the cash receipts from these taxes, which are estimated for this year at about a billion dollars, go into the general fund of the Treasury and are used to meet current expenditures. The special public debt obligations which are simultaneously created will in turn have to be met out of new taxes when they have to be paid. The burden, which gradually becomes much heavier, falls hardest on millions of people of small incomes, who do not understand how the law operates and whose very jobs may be threatened by the inevitable tendency of a heavy payroll tax to reduce employment.

Altogether, it is high time that we became aroused to the iniquity and the dangers of our present tax system, which if

continued threatens not merely the revenues but the progress of the country. It is encouraging that both Houses of Congress and their committees have already begun to make an exhaustive reëxamination of our tax laws, and that the Treasury under the leadership of the Secretary is working to the same end. Nothing would accomplish more toward the revival of business confidence and of business activity than the repeal of the undistributed profits tax, the reduction of the social security taxes and the revision of the law on a pay-as-you-go basis, and the moderation of those extreme rates of taxation which in themselves are unproductive and which are working so insidiously to discourage individual initiative and the future development of free enterprise.

Business recovery and sustained business activity are themselves, in large measure, the key to the state of the Government's finances, because of the extent to which they directly affect both revenues and expenditures. Recovery means less unemployment and therefore less demand on the budget for relief and other emergency expenditures. It also provides greater revenues for the Treasury and therefore the best chance for avoiding deficit financing and bringing about better-ordered national finance.

For the time being there is no doubt that we are experiencing a business recession of unusual suddenness and some magnitude. It lies largely in the hands of the political authorities, and the public opinion of the country as expressed through them, to determine whether it shall develop into a severe depression or terminate in a new and sounder recovery. Many factors are favorable. The dollar, for example, is not now overvalued and is not vulnerable, as it was in the last depression, to great foreign withdrawals. This year we have had the best crops for many years, and these, it seems to me, are still to be regarded as a blessing and not as a " national calamity ". Generally speaking, the material for recovery exists.

On the other hand business is still struggling under many handicaps and uncertainties which it is within the power of the Government to relieve. Apart from those which we have already discussed, there are still deadlocks in the great building and public utility industries, due mainly to Government competition, interference and hostility. These are unnatural and

unnecessary and could be broken with good will on both sides. The railroad industry, another great sector of the country's business, and the most regulated of all, is suffering from the pressure of increased costs and taxes, and the threat of declining traffic. Everywhere costs of production have been mounting, in part because of Government policies, and we need in all quarters a better realization of the resulting threat to business profits and business activity.

Above all we need to return to the " old-time religion ", of working and saving and living within our income, and abandon the dream that the Government is all-wise and all-powerful enough to plan or control all agriculture, business and industry. We have learned by experience that the general standard of living cannot be raised by policies of scarcity and destruction of wealth, and we must get back to that American ideal of honest work and free enterprise, through which the country has prospered and grown great. American enterprise, after all, is the primary source of employment, of production, and of the revenues on which the Government itself depends, and if not badgered to death by the Government it can and will go ahead under its own power under conditions of economic freedom. For this no great program of legislation or of new Governmental measures is necessary. The problem is rather to profit by the lessons which we have learned, to remove the handicaps which now prevail and release into new activity the pent-up forces of the nation.

REMARKS BY THE CHAIRMAN

MR. S. PARKER GILBERT: It is the great tradition of representative government that the "power of the purse" resides in the elected representatives of the people. This principle is firmly embodied in our Constitution. Originating in England as a check on the power of the King, "the power of the purse" has frequently become obscured, as Congressmen and Senators have regarded themselves as suppliants for their own constituents. Sometimes in recent years it seems to have been forgotten, and converted into "blank checks" given to the Executive. However much this may have been justified in times of great emergency, it is encouraging now to find many signs that the Congress is reasserting its prerogatives, and it is fitting that our first speaker this evening should himself be a member of the Congress and a leading exponent of its great traditions. Of a family long distinguished in American history, he has for years devoted himself in study and in practice to the problems of government and of public finance, and as Governor of Virginia he reorganized the finances of the Commonwealth and placed them on such a basis that they have withstood without strain the troubles of the depression years. Now in the U. S. Senate, member of its Finance Committee and of the Joint Committee on Organization of the Government, he can speak with authority on these questions. Friend and colleague of the Honorable Carter Glass, whom all Americans delight to honor, I have the honor to introduce the junior senator from Virginia, the Honorable Harry F. Byrd.

EXPENDITURES OF THE FEDERAL GOVERNMENT

HON. HARRY F. BYRD
United States Senator from Virginia

YOU have invited me to speak on the expenditures of the federal government, a subject that has interested me more than ever before because of my investigation as Chairman of the Senate Select Committee to Investigate Federal Agencies for Purposes of Government Reorganization. It is a big subject because the federal government has spent in seven years the incredible sum of 47 billions of dollars; and it is a vital subject because the prosperity of each American citizen depends on the preservation of the credit of the nation. We have added 22 billions to the public debt, and we are still adding day by day and hour by hour, and it is inevitable that the national credit will be impaired unless we retrench.

In the limited time assigned to me, it is difficult to cover the vast and complicated problem; hence, for the sake of brevity, I shall eliminate most of the fractions and speak in billions, as the government spends in billions.

Anyone in Washington today who discusses public finance in terms of less than a billion is regarded as a piker. Yet to spend a billion dollars in a year requires the disbursement of about $2,000 every minute of every day and night, including Sundays.

Today at Washington a public man is a liberal in proportion to how liberal he is with other people's money. Those of us in the Senate and House of Representatives who speak from time to time against gigantic waste and extravagance, that has exceeded any expenditure in the world's history, are berated as tories and reactionaries, as hard men, completely indifferent to human suffering. Yet, not a man in Congress today who has spoken and voted for economy and efficiency would hesitate to vote the sums necessary to protect any American against hunger and cold, and I believe would support sound and logical

expenditures, within the ability of the people to pay, to improve the conditions of those who do not now enjoy a decent standard of living.

It is easier to spend than to save. It is easier for a public official to respond to the pressure and propaganda of organized minorities than to attempt to merit the approbation of the inarticulate citizens who favor economy but do not take the trouble to express themselves either by voice or ballot. When the protection of public money against extravagant expenditure ceases to be a virtue, and a representative is mainly judged and rewarded by the magnitude of the appropriations he obtains for his district or state, economy and efficiency—most difficult at the best—become that much harder to accomplish.

Public spending grows by what it feeds on. The independent struggle of the individual to make a living for himself often weakens before the temptation to go on government relief. Of course there are thousands of cases for which public relief is necessary, but it is certain that money from the government in different forms, and I include in this observation the business man who seeks to borrow government money at lower interest rates than he could obtain elsewhere, establishes a powerful paid army to fight any retrenchment that may stop or reduce the payment to them of money collected from the taxpayers. Once federal employees believe they have a vested right to their jobs, once new departments and bureaus are established and allotted public funds and extended public privileges, including the free use of the mails for propaganda to prevent the loss of their jobs, once emergency spending is continued beyond the emergency, the stream of expenditures becomes an overwhelming flood which only heroic measures can keep from engulfing the nation.

I am only a business man. I do not believe in destructive economy, as my public record will prove. I favor adequate support for the functions of government. I readily agree that the activities of government must expand in times of emergency and that in normal times the aid of the government can properly and wisely be used to improve the condition of all the people. But I do say that a mandate for progress and welfare without a mandate for solvency is a mandate impossible of fulfillment and most likely a mandate for disaster.

A program to spend billions in the effort to increase social justice is limited, within reason, by the ability of the nation to pay and still maintain our system of government. It is quite true that human values may be conserved and promoted by better health, better housing and better living, and that these are much more important than property values; yet, social security built upon debt is a house built upon the sands. True liberalism requires the government to keep its resources unimpaired, to prevent distress and to coöperate with the localities in providing for the poor in emergencies, because it is the poor who suffer the most when business is bad and unemployment increases. Other emergencies will come, and we must not exhaust our resources to the extent that we cannot meet the responsibilities of the next one.

In speaking tonight I shall talk very frankly of the serious significance of huge government spending. I speak as a friendly critic. I am a member of the political party, many of whose leaders actually claim credit for the expenditures of the last four years. The Republican party, likewise, cannot deny its share of responsibility. Five billions of our present debt was created under Mr. Hoover; and a majority of Republicans in the Senate and the House voted for most of the appropriations that made possible our present spending program and created the new indebtedness of the last four years. It is only fair also to recall that many business men and other citizens urged spending as a panacea for the depression. The slogan, "prime the pump and spend ourselves back to prosperity", became exceedingly popular, and the Congress was urged to enact bigger and greater appropriations.

I shall not consume time in generalities and in the exposition of accepted economic principles. We know that the budget must be balanced soon or disaster must inevitably come. We know that excessive taxation is a barrier to future progress and destructive of present prosperity. But there is yet time to save this perilous situation. The credit of the government is still sound, but will not remain sound if we continue to spend on the present extravagant and enormous basis.

I am not an alarmist. I am conscious of the great financial resources of America. However, in six years the increases in the federal debt have been more than four times the total wealth

of my own state of Virginia, a wealth that Virginians have been accumulating by frugality and industry for more than three hundred years. Virginia is an average state in wealth and population, so that our new debt represents the total value of all the property of every character owned by citizens of four sovereign states of average wealth and population. We cannot safely dissipate so much of our resources.

This enormous debt today becomes more disturbing as we face the prospect of new debts caused by continuing deficits. The time has come to begin to retire this debt created in the emergency of the depression, as we did after the World War; yet spending is not being reduced and the federal income is dwindling.

President Roosevelt admirably and eloquently expressed the supreme importance of maintaining sound fiscal policies when he said on October 19, 1932:

> We all know that our own family credit depends in large part on the stability of the credit of the United States. The credit of the family depends chiefly on whether that family is living within its income, and so it is with the nation. If in some crisis it lives beyond its income for a year or two, it can usually borrow temporarily on reasonable terms. But if, like a spendthrift, it throws discretion to the winds, is willing to make no sacrifice at all in spending, extends its taxation to the limit of the people's power to pay, and continues to pile up deficits, it is on the road to bankruptcy.

The President was right! The credit of the United States is the foundation upon which our system of credits must rest. Destroy faith in the credit of the nation and our whole system of credits will collapse. The federal government has no power to create wealth. It can print those counters we call money, but real wealth is created by the application of human industry to the national resources. Real wealth is mostly the wealth that comes either from the surface of the earth or from the riches beneath the earth. New wealth is not the result of new theories of finance or banking or ingenious legislation. Ladies and gentlemen, it is a dangerous thing to spend wealth faster than new wealth is captured from God's eternal granary; and yet, this is what we have done in prodigal fashion. For six years consecutively expenditures by the federal government alone have greatly exceeded each year the combined gross value

of all agricultural products and all the products of mines, even after inflating the farm income by government payments. This has never occurred before in the history of America except in the two years of 1918 and 1919 when we did more than our part to finance the most expensive war in history.

The justification assigned for vast public spending has been the need of overcoming conditions created by the depression that Mr. Roosevelt inherited when he came into office in 1933. I was in the Senate during those trying days. I give full credit to the President and the Congress for the many brave and necessary things that were then done to relieve distress and restore confidence.

Five years have passed and our recovery justified the President in saying in Wyoming on September 24, last: "The greater part of the emergency is over." We cannot continue indefinitely emergency remedies.

In 1930 the gross debt of the federal government was 16 billions. It had been reduced from the World War peak of 26 billions by the payment of about a billion each year during the twenties. On November sixth the direct gross debt of the federal government was the startling and stupendous sum of $37,019,677,682.77. In addition, our government has guaranteed in full the obligations of 25 wholly owned government corporations and partially guaranteed the obligations of 10 semi-government corporations. This contingent liability is approximately 5 billions, and all this makes the total direct and contingent obligations today approximately 42 billions. It is true that this gross debt is subject to such credits as may come from recoverable assets and the ultimate liquidation of the 35 corporations whose obligations have been guaranteed by the government in whole or in part. However, an examination of these numerous guaranteed government corporations discloses a ramification of their liabilities and assets that confuses the most experienced economic experts. Years will pass before the recoverable value can be appraised and the actual credit on the present 42 billion gross liability of our government be determined.

I feel completely safe in saying that the credits and recoverable assets shown in the government reports have been grossly overestimated. Take, for example, the Reconstruction Fi-

nance Corporation. The government purchased $500,000 of stock and about $4,000,000,000 of notes of this corporation. The stock and the notes are carried on the government reports at face value, leaving the impression that the total assets represent sound values and will ultimately be recovered into the treasury to reduce the public debt. This conclusion is accepted by the public by reason of the confidence in the soundness and efficiency of the chairman, Mr. Jesse Jones.

However, the Brookings Institution, employed by the Senate committee on reorganization, recently disclosed that two and a half billions of the assets of the R. F. C. were diverted for relief expenditures and to pay the regular expenses of other agencies and for other expenditures, none of which is recoverable. So today the stock of the R. F. C. is valueless and the notes are not worth more than fifty cents on the dollar in recoverable assets. Yet only recently the Corporation issued a financial statement showing and claiming a surplus of 150 millions as of December 31, last.

Why was this devious and misleading method adopted by the officials responsible for recording appropriations? An inquiry from me to a high budget official brought the response that the only reason he could assign was the desire to avoid huge totals in the regular appropriation bills. Mr. Jesse Jones, the able chairman of the R. F. C., is not responsible for this confusing statement. I happen to know that he has been endeavoring to have the balance sheet, as issued by the United States Treasury Department, corrected in order that it may reflect the facts. But even Jesse Jones, as able a business man as he is, cannot collect from Harry Hopkins money already spent for relief. Either two and a half billions should be appropriated to maintain the integrity of the R. F. C. assets or legislation should be passed to write down the securities to true value.

The financial reports of the government should be an example of clear and candid statements such as the government requires by law from private business; and it punishes by imprisonment any business man who violates this proper law. The complexity of the contingent liability of the government and the difficulties of liquidation cannot be discussed in the limited time of my address, yet we should realize that the

losses in guaranteed obligations—and such losses are certain to be large—must be met some day as a government expense and either added to the direct debt or paid by current taxes. The federal government has endorsed with full recourse the notes of these numerous corporations and, like any other endorser, must pay if the maker of the obligation fails to pay.

The Twentieth Century Fund, an independent fact-finding agency, says that our total government debts—federal, state and local—of 56 billions, are "the largest that any nation has ever had." This competent authority calls this debt a great potential peril and recommends that in the next fiscal year a billion at least be paid out of current federal revenue for debt retirement.

We are now entering the eighth consecutive year in which our government spends much more than its revenue. In our previous history, the longest period of substantial successive deficits was two years. In the three war years, after deducting loans to Allies, our government spent for normal and war expenses only a little more than it has spent in 1935, '36 and '37—25 billions against 24 billions.

Now let us see what the tax burden means in terms of each American family. Let us bring to roost these prolific tax chickens. In 1913 the per capita income was $350. In 1936 it was $469, an increase of 34 per cent. Total government expenditures equaled $30 per capita in 1913 and $134 per capita in 1936, an increase of 347 per cent. On a per capita basis, government expenditures in 1913 represented 8 per cent of the national income. In 1936 these expenditures represented 28 per cent of the national income. Public debt equaled $59 per capita in 1913 and $430 per capita in 1936. Today about one third of every person's income would be required to meet government expenditures, if we paid as we spend. These figures, of course, refer to total government cost. Many of the states, cities and counties have yielded to the contagion of extravagance. The children of Uncle Sam have followed his bad example. In 1936 the deficits of all governments in America were 7 billions, nearly 5 billions of which were created by the federal government.

Should we not hearken even to the few voices crying in the wilderness? When we cite these terrifying figures someone

always cries, "What, would you deny relief to human suffering?" No, we would not let anyone starve in this country, but the disturbing thing is that the increase in the regular expenses of our federal government is enormous in addition to the expenditures for recovery and relief.

During the prosperous years of the twenties our government spent about three billion dollars each year and paid a billion a year to retire the World War debt.

To get the debt back to what it was seven years ago we must pay one billion each for twenty-two continuous years. Not even with uninterrupted prosperity for a whole generation could the people and the business of the country sustain the terrific burden necessary to run the government on this basis and make this debt retirement. To do so would require nearly a thirty per cent increase in our 1938 annual tax collections, and remember that this year our tax collections are estimated to be the largest in our history and only approached by one single year—in 1920—when war profits were subjected to high tax rates.

I want to introduce to you the mysteries of the two budget system. *I declare that our expenses are now being leveled off on the seven billion basis because of the gradual transfer of emergency expenditures to the regular budget.* In 1934 the federal government adopted the two budget system; one for emergency and the other for regular expenses. We have two budgets but we have only one treasury. In 1934 the regular budget presented to the Congress by the President was two billions, seven hundred millions. *In 1938 the regular budget is five billions, four hundred millions—an increase of one hundred per cent in four years.*

A reduction is shown in the statement of recovery and relief expenditures because many of the items of emergency expenditures have been made permanent by transfer to the regular budget. An example is the appropriation for the C. C. C. camps, which was first in the emergency budget and is now included in the regular expenses. But there has been no reduction in our total expenditures, and excluding the non-recurring soldiers' bonus, we will spend as much or more in 1938 than we spent in 1937, or in any previous depression year. This year, to date, we have actually spent more than in the same period of last year.

At best it is most difficult to comprehend the expenditure of billions, but the confusion has been greatly increased by this strange device of keeping two budgets. When the administration announces a reduction in spending for recovery and relief, at once we begin to feel better and to think that finally we can look forward to a real reduction, but later we find the regular budget has been increased, and the total is as much or more. We have juggled expenditures back and forth from one budget to the other, but the taxpayers pay the bill for both budgets. The two-budget system has merely aggravated the general confusion.

It is disturbing to see the astounding and progressive increases in the regular expenses after eliminating all items in the emergency budget. The following table of regular budget expenditures comes from official government auditors and does not include recovery and relief expenditures:

Regular Expenditures

1934	$2,700,000,000
1935	3,200,000,000
1936	3,300,000,000
1937	4,400,000,000
1938	5,400,000,000

When we add expenditures for recovery and relief, for public works, for the huge slum clearance program begun at the last session, for additional T. V. A.'s, for the cost of the new farm program and other costly projects, either already recommended or under consideration, it is conservative to say that we have reached the level of a seven billion annual expenditure without debt retirement—in fact considerable restraint must be exerted to hold it to this huge figure. This year we shall spend more.

Only a major surgical operation to reduce expenditures will enable us to carry the burden of sustaining this annual cost and commence to retire our emergency debt.

The difficulties of ascertaining the true expenditures are made greater by the policy of the government in deducting from expenditures an excess of loans collected over loans made. In this manner the combined expenditures in 1937 were reduced in total by two hundred forty-three millions. Of course the excess collected of capital loans should be applied to a reduction of the public debt.

In the budget of 1938 two hundred thirty millions of social security taxes are used for regular expenses. The effect of this will be to reduce the deficit by the use of a tax, ***collected and paid*** for the specific purpose of providing old-age security.

One may imagine the denunciation a corporation would receive from the government if it indulged in such improper financing and used for current expenses an income dedicated to a trust fund for the security of the aged.

Nothing Congress has done has contributed more to extravagance, and done more to destroy the budget system, than the practice of making lump sum appropriations. About fifteen billions of such appropriations have been made in the past four years as compared to one and one-half billion of lump sum appropriations in all the previous history of our country. From these lump sum recovery and relief appropriations, equivalent as they are to blank checks, great sums have been diverted for expenditure by the regular departments, thus expanding the activities of these departments. Over three billions of lump sum appropriations, made for recovery and relief, were allocated for expenditures by regular departments in 1934, 1935 and 1936.

I know something personally of the waste involved in lump sum appropriations. An allocation from a lump sum appropriation was made for the construction of homes in Virginia to be rented to mountain people, costing complete including land and all other costs about $8,000 per home. I had no opportunity to vote on this appropriation for my own state. A competent builder offered to reproduce one of the homes for $900, yet my requests to stop this waste near my own home were unavailing. I introduced a bill to cancel the appropriation, but the department is working under pressure to expend all the fund before Congress meets. In the same manner the Resettlement Administration has built about fifteen thousand homes throughout the country, some costing more than $16,000 per home unit, for rental to the low income group. In some instances the General Accounting Office estimated the overhead expense to be forty per cent.

The huge deficits that have been added to the public debt are not due to failures of the revenue. Taxes have been increased so that in 1938 we anticipate the highest income in the history of our country.

If we were maintaining a balanced budget, even the painful exaction of enormous taxation from our people might be justified as a patriotic imposition to meet a period of national economic peril expected to be temporary; but we are paying the taxes without balancing the budget. Our people are paying these painful taxes without relief from the conditions that cause the pain. The patient who suffers acute physical pain should be relieved by morphine, but the cause of the pain must be removed or the continuous administration of morphine will make the remedy worse than the disease.

Why disguise our condition? A true diagnosis must precede an effective remedy, and a true diagnosis requires a frank and fearless recognition of our economic predicament.

What is our situation today? We work under the load of the most stupendous debt any nation has ever carried. Our taxes are reaching the point of diminishing returns and today are a decided factor in the high cost of living. Remember that more than half of the taxes collected by the federal government come from invisible taxation paid by the housewife, the laborer and every one who eats or buys necessities. Last year forty-three citizens had incomes of over one million and the aggregate of these incomes was seventy-three millions. If we confiscated all of the incomes of these millionaires, the money obtained would operate the national government for only about three days. The rich must bear a just share, yet these figures prove the futility of confiscating property to sustain our great expenditures.

Let us not be deceived, the people as a whole will pay most of this vast debt and carry this heavy national expenditure.

We have suspended the terms of statutory debt requirement that provide for annual contributions to the sinking fund in ratio to the public debt. We have assumed the responsibility at heavy cost to maintain an artificial price of gold throughout the world. We are buying and burying in the ground in a costly mausoleum at Fort Knox the same gold that was dug out of the ground under the impression that it was usable precious metal.

The federal government is now paying on its obligations a low interest rate because money is cheap. Our guest tonight, Secretary Morgenthau, has admirably managed the issuance of

obligations at the lowest possible interest rates. But when the obligations become due—and fifteen billions are due in the next five years—we face a likely increase in existing rates. The obligations given by the government to the Social Security Trust Funds bear by law 3 per cent interest—an increase of one-half per cent over the average rate now paid. An increase in interest rates will remain for a long time as a potential new burden on the treasury. An increase of one per cent means $400,000,000 annually more to be paid by taxation.

We are told that a balanced budget is on the way. I cannot credit this prophecy. On the contrary, I predict that on July 1, 1938 the estimated deficit of eight hundred ninety-five millions will be at least twice that sum. Without reduced spending the outlook for 1939 is equally gloomy because the business recession, as predicted even by government officials for 1938 and already felt by business men, will be reflected in revenue receipts for the 1939 fiscal year.

My reasons for predicting a much larger 1938 deficit are, first, the revenue will not reach the estimates; and, second, the President has allowed only one hundred and eighty millions in his estimate for deficiency and new appropriations in the next eight months while our deficiency and new appropriations in 1937 were nearly a billion dollars.

The excessively high receipts estimated to be received from the undistributed profits tax will never materialize. This new tax system has failed as a revenue producer and has been a decided barrier to business recovery, for this law taxes a corporation an additional 27 per cent for spending current revenue to build new plants and provide new employment. When a main problem of America is unemployment, it is a strange theory to penalize by extra taxation a business enterprise desiring to expand and employ more people. Capital must go to work to carry the present burden of unemployment, but no enterprise can expand and pay a high additional tax penalty for doing so.

As I conclude, I anticipate some may say, "Well, what would you do about it?" The only constructive thing to do is to stop writing checks. Talk neither pays debts nor reduces expenses. We have talked economy, but nothing has been done about it. As one who has devoted months of study to

government spending, assisted by competent experts, I declare advisedly that we have the most costly and wasteful bureaucracy at Washington in the history of the United States of America. We have created in four years over fifty new agencies and many more bureaus and subdivisions. We have more than doubled in four years the federal employees in the city of Washington and the last report shows we are still adding new employees.

Hundreds of millions can be saved in administrative and overhead expenses and simplifying the duplications of government agencies. Other hundreds of millions can be saved by eliminating waste and extravagance from necessary activities and by abolishing altogether the less essential activities. We should and can at once go on a pay-as-you-go basis—not by new taxes, but by retrenchment.

You must remember that public economy like private economy is neither spectacular nor attractive. It is a steady, hard, uninteresting grind. The home band does not often turn out to greet a returning economizer. We talk a lot about it and do little. But under our present perilous situation the longer we defer economy the greater and more terrible the penalty we will pay.

Remarks by the Chairman

Mr. S. Parker Gilbert: The historic rôle of the Secretary of the Treasury is to protect the public credit at home and abroad, to finance the Government's needs, to supervise the public revenues, and generally to act as guardian of the finances of the nation. Called to these high responsibilities in the autumn of 1933, and serving through these years of unusual stress and strain, the present Secretary has risen to the high traditions of his office, and it is due largely to his honest and inquiring mind and careful judgment that we have avoided many of the pitfalls which beset us. In difficult times he has successfully discharged the heavy task of financing the Government's requirements, and has been giving his best efforts to reëstablishing effective control over Government expenditures. Now, under his leadership, plans are under consideration for revision of the revenues which will be of great importance to the future of the country. We are greatly honored by his presence with us tonight, and I now present to you the Secretary of the Treasury, the Honorable Henry Morgenthau, Jr., of New York.

FEDERAL SPENDING AND THE FEDERAL BUDGET

HON. HENRY MORGENTHAU, JR.
Secretary of the Treasury

I welcome the opportunity to discuss before the members and guests of the Academy of Political Science the subject of federal spending and its relation to the balancing of the federal budget.

Nineteen years ago tomorrow we signed the Armistice ending the World War. That war was enormously costly in human values, and it was enormously costly in material values. In the two years between the middle of 1917 and the middle of 1919, the federal government sustained a net deficit of twenty-two billion dollars.

During the past four years this country has been engaged in another war. This time our enemy was a great economic disaster. In this war we fought with jobs and with dollars to save farmers from losing their farms; to save home owners from losing their homes; to give not only bread but work to the unemployed; to increase the security of jobs, property values and business profits; and to bring order out of chaos in our economic system.

This war, like that other war, required a many-sided campaign under intelligent and courageous leadership—a leadership that was magnificently supplied by President Roosevelt.

Finally, this war, like that other war, required a large spending program. This program, plus the special needs arising out of the great drought and the prepayment of the soldiers' bonus, necessitated net outlays during the four years ended June 30, 1937, of some fourteen billion dollars in excess of our receipts.

Of course, it is easily possible to criticize some of the detailed uses of the relief funds. Let us concede that there was some waste. In any expenditure program of such magnitude this is inevitable. But, contrasted with the human and material values at stake, such wastes as may have occurred shrink into insignificance.

We deliberately used an unbalanced federal budget during the past four years to meet a great emergency. That policy has succeeded. The emergency that we faced in 1933 no longer exists.

I am fully aware that many of our problems remain unsolved. I am aware that there still remains a considerable volume of unemployment; that the speculative markets have recently been under severe pressure; and that our business indexes have recently shown a declining tendency. I am further aware that some persons contend that another great spending program is desirable to ward off the risk of another business depression.

I claim no prophetic insight into the future. But, after giving serious and careful consideration to all of these and other factors, I have reached the firm conviction that the domestic problems which face us today are essentially different from those which faced us four years ago. Many measures are required for their solution. One of these measures, but only one, in the present juncture is a determined movement toward a balanced budget.

Early in 1933, after three years of progressive deterioration, our whole economic mechanism was demoralized. Under these conditions, there was no agency outside of the federal government with the resources and the courage to bring about a business revival.

Today the situation is greatly changed. We are now nearing the end of one of the most active years in the business history of this country. On the whole, this high level of activity has been of a healthy character—not of the character that usually marks an unhealthy boom and precedes a serious depression. The present situation is not characterized by the existence of huge inventories, high interest rates, over-extended credit positions, or great surpluses of housing and capital equipment. We have not reached the stage of full employment of our productive resources. On the contrary, from all these standpoints, conditions are favorable for a continued increase in the level of business activity.

This stands in contrast to the unhealthy excesses of 1929. It stands in even sharper contrast to the banking collapse, the bread lines, the bankruptcies and the general demoralization of 1933.

Despite the substantial increase in the public debt during the past four years, the credit of the federal government has remained absolutely unimpaired. Not once during even the darkest days of the depression did the treasury experience the slightest difficulty in borrowing all the funds that were required. Moreover, the rates of interest on our borrowings have been lower, for comparable securities, than at any other time in the history of the country.

But the underlying conditions that made deliberate deficit spending the wisest kind of policy during the depression have been altered during the progress of recovery. Thus, when we borrowed during the depression to finance our deficit spending, a large part of the funds was obtained through an expansion of bank credit. To this extent, our spending did not absorb capital funds that might otherwise have gone into private industry, nor did it absorb by taxation funds that might otherwise have gone into private consumption. Even to the extent that our bonds and notes were purchased by non-banking investors, the effect was largely to put to work capital funds that would otherwise have remained idle.

Our industrial recovery of the last year, however, has created large new demands for private capital. Our commercial banks have been again utilizing their credit resources for the financing of private industry. During the present calendar year, the insured commercial banks of the country have substantially reduced their holdings of government securities in order to meet actual and prospective demands for commercial credit. The obligations that they sold, plus an amount equal to the securities newly marketed by the treasury, were purchased by investors. Any deficit spending under conditions of active demand for private capital would have to be financed in large part by capital funds that would otherwise be available for business purposes.

The basic need today is to foster the full application of the driving force of private capital. We want to see capital go into the productive channels of private industry. We want to see private business expand. We believe that much of the remaining unemployment will disappear as private capital funds are increasingly employed in productive enterprises. We believe that one of the most important ways of achieving

these ends at this time is to continue progress toward a balance of the federal budget.

I turn now to the immediate practical aspects of budget balancing for the coming fiscal year. What are the controlling figures?

Our total receipts for this year were estimated in the President's budget summation of October 19 at about six billion six hundred and fifty millions, and our total net expenditures at about seven billion three hundred and forty-five millions, leaving an estimated net deficit of six hundred and ninety-five millions.

To attain an ordinary balancing of the budget next year—that is, a balance after full provision for accruing liabilities for old-age benefit payments, but exclusive of debt retirement—it would be necessary to accomplish a net improvement of about seven hundred million dollars in our budgetary position, as last estimated. To be prudent, we should not count on an increase in revenues next year from the existing tax structure. Nor should we impose additional taxation. Instead, we should plan to bring next year's expenditures within this year's income.

But where can cuts totaling seven hundred millions be made? After a careful study of the whole problem, I have come to the following conclusions. On the one hand, while everything possible is being done and will be done to keep a tight rein on the regular operating expenses of the federal government, including the national defense and interest on the public debt, I do not believe that we can find large savings in this field. Further, our expenditures under the Social Security Act will increase next year.

On the other hand, by focusing attention on the several classes of expenditures that have been mainly responsible for our past deficits—namely public highways, public works, unemployment relief and agriculture—it is apparent that great savings can be made.

Let me give you an idea of the possibilities for savings in these fields.

First, take the item of highway expenditures. Prior to the depression, the federal grants to the states for public highway construction generally ran under one hundred million dollars annually. This year the total federal outlays for highways,

inclusive of emergency expenditures, are estimated at two hundred fifty-three millions; and in addition, the existing highway programs call for new appropriations totaling more than four hundred million dollars for the next two years. I believe it is now time to return to the average annual level of highway expenditures that existed prior to the depression, especially because during the past few years many other millions of dollars have been spent for highways out of relief appropriations.

Second, there is the field of public works, other than highways, on which we are spending five hundred seventy-three millions this year. This is a greater sum than the total that was spent for this purpose during the entire five-year period between 1926 and 1930, inclusive. Next year, despite the fact that there will be available from appropriations and allocations already made for this purpose more than six hundred millions, I believe that we can and should move definitely toward a lower level of public works outlays.

Third, I sincerely hope that employment conditions will make possible a further substantial reduction in our outlays for unemployment relief and the C. C. C. camps. During the present fiscal year, by reason of more active private business, these expenditures are already being reduced by more than seven hundred fifty millions below last year's.

I turn next to our expenditures on behalf of agriculture. The total of this year's expenditures, exclusive of public highways, for the regular activities of the department, the soil conservation program, rural electrification, resettlement, commodity loans, and lower interest rates for federal land bank borrowers, exceeds nine hundred million dollars. Despite the magnitude of this sum, you are all aware that possible further measures involving large additional expenditures are now being discussed.

I am strongly in favor of a long-range program to maintain the independence and the purchasing power of the farmer. Such a program must take into consideration the farmer's opportunities in the foreign markets as well as in those at home; and no agricultural program can long endure which makes excessive demands upon the federal treasury, or is unfair to consumers. The farmer himself does not want subsidies, but

rather such fair prices and such balanced production of crops as will make subsidies unnecessary for his decent economic status.

Balancing the budget is as much in the interest of farmers as in the interest of other parts of our population; and it requires the coöperation of the farmer as well as of other sections of the public.

Only with the solid backing of the public can we hope to achieve economies totaling seven hundred millions in the four fields that I have cited.

There may be some persons who would counsel a more drastic reduction of expenditures or a program of far heavier taxation in order to make certain a more substantial reduction in the public debt in the next fiscal year. There are serious objections to either of these courses.

I have already indicated that I believe it undesirable to increase taxation. There are equally compelling reasons why we should not reduce expenditures too suddenly and too drastically. I strongly favor a vigorous program for the progressive reduction of federal expenditures to the minimum demanded by the government's responsibilities.

Obviously, however, one reaches a point in reducing government expenditures at which no further reductions can be made, unless it is decided to cripple many essential governmental activities—in other words, unless it is decided to make drastic changes in national policy. For example, it would mean consideration of such things as weakening our national defense, and slowing up or abandoning flood control, soil erosion prevention, and relief for the aged and the unemployed. Such a course, I believe, would not have the approval of either the American people or their elected representatives in Congress.

Moreover, it would clearly be disastrous to many of the needy unemployed, and disruptive to many sections of private industry, if we were to cut government expenditures in the coming fiscal year by much more than the amount I have indicated.

We are definitely in a transition period between unbalanced and balanced federal budgets; but I firmly believe that there is just as much danger to our economy as a whole in moving too rapidly in this direction as there would be in not moving at all.

Relatively few persons realize the striking fact that the net improvement this year in the budgetary position of the federal government as estimated will amount to more than two billion dollars. In other words, the net deficit this year is estimated at less than seven hundred millions as compared with more than two billion seven hundred millions last year.

This net improvement of more than two billion dollars in a single year provides the best answer to those who, in most cases ignorant of the true facts, have publicly despaired of our ability to balance the federal budget.

True, much of this year's anticipated budgetary improvement comes from increased revenue, but we are supplementing this by also seeking reductions in expenditures.

In addition to these considerations, I should like to point out that, as a result of the Social Security Act and related state laws, it is estimated that the federal government next year will receive more than one billion dollars net for investment in government securities for the Unemployment Trust Fund and the Old-Age Reserve Account. Although this investment will not change the total amount of the public debt, it will with a balanced budget result in the transfer to these reserve accounts of more than a billion dollars of government obligations now held by private investors.

Even during the decade of the twenties, when the treasury was receiving large payments of interest and principal on war debts, and from the sale of surplus war materials, the maximum reduction made in any single year in the public debt held by private investors was about one billion three hundred millions. The rate at which it is safe to reduce the public debt in private hands depends upon the rate at which private funds flow into investment channels. It is unsafe to go too fast.

Although we are not contemplating any increase in the total tax burden, the character of our tax structure is being given earnest consideration.

The federal tax system affects everyone in the country. We in the treasury in studying tax problems have two objectives always before us: first, that the tax burden shall be distributed as fairly as possible, and second, that the collection of taxes shall be as little burdensome to the taxpayer as possible.

It is with these aims that, by direction of the President, we

have been reviewing the whole tax structure in the last few months and are just now in the process of presenting to a committee of Congress the information we have collected. The study has not been directed toward raising additional revenue. Instead, we have sought to determine whether there are inequalities and injustices in the distribution of the tax burden and whether there are some taxes whose costs of collection and whose burdensome effect outweigh the revenue gain. In addition, we want to simplify collection and make the taxpayer's record-keeping less difficult.

We realize that our tax laws are too complicated; we want to make them less so. We realize that there are inequities; we want to eliminate as many of them as we can.

In making this study, we have invited the assistance and the advice of groups of taxpayers and of individuals. We want to hear the taxpayer's side of the story. We want all the facts we can get and we have obtained both facts and opinions.

Our tax revenues come largely from individual earnings and business profits. We do not wish to impose levies which tend to dry up the sources of tax revenue. The laws should be so written and administered that the taxpayer can continue to make a reasonable profit with a minimum of interference from his own federal government; provided that the taxpayer cooperates with his government in carrying out the purpose and the spirit of the tax laws. Of course, tax policy cannot properly be determined from exceptional cases. We must look at the whole picture. We base our decisions on extensive information and upon analysis of actual tax records.

The amount of our income-tax revenue is only about half our total internal revenue. Less than three million people out of our total population pay individual federal income taxes. We would be applying the principle of capacity to pay more justly if we were to reduce the number of consumer taxes and at the same time to increase the number of income tax payers. Taxpayers who are squarely confronted with their own tax burdens are bound to be keenly alive to the way the money is being spent by their government.

The budget now nearing completion is predicated on a definite estimate of receipts, based on the existing tax structure. It is a cardinal point of our policy that the tax system, as

revised, must not yield a smaller return for 1939 than the present system would yield.

Let me repeat: We want to adjust inequalities and remedy defects in the tax laws. In doing this, we have sought the help of the taxpayer and have given him a sympathetic hearing. If we find that the operation of any particular tax is unfair, we stand ready to say so publicly.

My object this evening has been to present, as clearly and as frankly as I know how, a comprehensive picture of the federal expenditures and the budgetary outlook. I have tried to make plain the underlying economic reasons, as well as the humanitarian ones, for the past deficits; and I have tried to bring out clearly the considerations that now demand further definite steps toward a balanced federal budget. I have shown why, in my opinion, this balance should be sought by a reduction in expenditures without an increase in the total of the tax burden. But I have also shown that there is a limit to reductions; and that balancing of budgets needs the help of industry to keep up total tax receipts unless we are again to resort to deficit financing.

The principal aims of our budgetary policy have been, and I hope will continue to be, to promote a high level and healthy character of business activity, a maximum volume of employment at good wages in private industry, a reasonable return to capital and enterprise, fair treatment for our agricultural population, and adequate revenues to meet the services now demanded of the federal government.

The attainment of these ends rests very greatly on private initiative and on the coöperation of private enterprise. This is a necessary supplement to any efforts which the government can put forth. This administration is going to do everything possible to promote a continuation of recovery and to balance the budget through cutting expenditures. But I wish to emphasize that in no event will this administration allow anyone to starve, nor will it abandon its broad purpose to protect the weak, to give human security and to seek a wider distribution of our national income. We are confident that, with the full coöperation of the business world, our present difficulties will be overcome; and that the aims that I have set forth above, which are properly those of private business as well as those of the national government, will be achieved.

Remarks by the Chairman

Mr. S. Parker Gilbert: Ladies and Gentlemen—In bringing this Annual Meeting of the Academy to a close, I should like to express, in your names and in the name of the Academy, the thanks of us all to the distinguished speakers who have contributed so much to the sessions held during the day by their interesting and illuminating papers on various phases of the general subject which we have been discussing tonight.

I should also like to express the thanks of us all to the distinguished speakers who have honored us by their presence tonight, and especially to the Secretary of the Treasury who has come from his heavy official responsibilities to give us this message concerning the government's budgetary and financial policy.

THE PROCEEDINGS ARE ISSUED TWICE A YEAR
THIS IS THE FIRST ISSUE FOR 1938

PROCEEDINGS
OF THE
ACADEMY OF POLITICAL SCIENCE

Volume XVII] JANUARY 1938 [Number 4

EXPENDITURES OF THE FEDERAL GOVERNMENT

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE ANNUAL
MEETING OF THE ACADEMY OF POLITICAL SCIENCE
NOVEMBER 10, 1937

EDITED BY
JOHN A. KROUT

PUBLISHED BY
THE ACADEMY OF POLITICAL SCIENCE
COLUMBIA UNIVERSITY
116TH STREET AND BROADWAY, NEW YORK

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